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TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1937

No. 189

BENJAMIN B. FOSTER AND ROBERT R. TODD, EXECUTORS OF THE ESTATE OF ANNA FOSTER FORD, DECEASED, PETITIONERS,

vs.

THE UNITED STATES

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

PETITION FOR CERTIORARI FILED JULY 2, 1937.

CERTIORARI GRANTED OCTOBER 11, 1937.

SUPREME COURT OF THE UNITED STATES

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INDEX.

	Original	Print
Record from Court of Claims	1	1
Petition	1	1
General traverse	11	7
Substitution of parties plaintiff	11	7
Argument and submission of case	11	7
Special findings of fact	12	7
Conclusion of law	16	11
Opinion by Green, J.	16	11
Judgment	21	15
Proceedings after entry of judgment	21	15
Opinion on motion for new trial, Green, J.	22	15
Order overruling motion for new trial	26	19
Clerk's certificate (omitted in printing)	27	
Order allowing certiorari	28	20

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[fol. 1]

IN UNITED STATES COURT OF CLAIMS

No. 42642

ANNA FOSTER FORD, Plaintiff,

v.

THE UNITED STATES OF AMERICA, Defendant

I. PETITION—Filed April 17, 1934

To the Court of Claims of the United States and to the Honorable, the Judges thereof:

The above-named plaintiff by this, her petition, respectfully shows:

[fol. 2]

1

That during the calendar year 1930 your petitioner, Anna Foster Ford, was an unmarried citizen of the United States and a resident of Kansas City, Missouri.

2

That under and pursuant to the provisions of an Act of Congress approved May 29, 1928, and entitled, "An Act to Reduce and equalize taxation, provide revenue, and for other purposes," 45 Stat. 791, petitioner prepared, and on, to-wit, March 12, 1931, duly filed with the Collector of Internal Revenue at Kansas City, Missouri, her income tax return for the calendar year 1930, on a form furnished by the Commissioner of Internal Revenue. The said income tax return filed by your petitioner showed an income tax liability of $850.28, all of which said sum was paid to the Collector of Internal Revenue at Kansas City, Missouri, on, to-wit, March 12, 1931, at the time of the filing of her income tax return for the calendar year 1930.

3

That your petitioner has paid no further sum than the aforesaid $850.28 as and for her income tax liability for the calendar year 1930 and she has received no refund or credit of any part of the taxes paid by her for the calendar year 1930.

[fol. 3]

4

That your petitioner was, on February 11, 1930, the owner of record of 155 shares of a par value of $100.00 per share

of the total of 1500 outstanding shares of the capital stock of the Foster Lumber Company, a Missouri corporation, with its principal place of business in Kansas City, Missouri.

5

That on February 11, 1930, the aforesaid Foster Lumber Company declared a cash dividend of 150 per cent on its capital stock payable on that date to all stockholders of record on that date. Your petitioner received during the calendar year 1930 the amount of $23,250.00 as and for dividends pursuant to such dividend declaration.

6

That your petitioner included the full amount of the aforesaid dividend received by her from the Foster Lumber Company during the calendar year 1930 in the amount of $23,250.00 in her income tax return for that year and paid a tax on the entire amount thereof.

7

That thereafter your petitioner was advised that of the dividend of February 11, 1930, distributed to her the amount of $14,754.22 was non-taxable as being a distribution by the Foster Lumber Company from its earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913.

[fol. 4]

8

That on, or about, July 18th, 1932, and within the period provided for by statute, your petitioner duly filed with the Collector of Internal Revenue at Kansas City, Missouri, a claim for the refund of $712.01 of the taxes paid by her for the year 1930. The claim was predicated on the basis that of the dividends of $23,250.00 received by her from the Foster Lumber Company during 1930 and reported as taxable in their entirety in her income tax return for 1930, the amount of $14,754.22 was paid out of surplus accumulated, or appreciation of land and timber arising, before March 1, 1913, which amount was under the statutes exempt from tax. The Commissioner of Internal Revenue rejected the said claim for refund under date of September 21, 1933.

9

Your petitioner avers that on March 1, 1913, the earnings or profits accumulated, and increase in value of property

accrued, prior to that date of the Foster Lumber Company were in the amount of, to-wit, $3,766,011.25.

10

That the following schedule shows with reference to the Foster Lumber Company in column "A" the period involved, in column "B" the amount of the earnings or profits for that period, in column "C" the amount of the dividend distributed on the last day of that period, and in column "D" the balance of the earnings or profits accumulated subsequent to February 28, 1913:

[fol. 5]

"A" Period	"B" Earnings or Profits	"C" Distributions	"D" Balance of Earnings or Profits Accumulated Since February 28, 1913
Mch. 1, 1913 to Dec. 31, 1913.....	$54,343.62	none	$54,343.62
Jan. 1, 1914 to Feb. 10, 1914.....	3,278.67	$100,000.00	none
Feb. 10, 1914 to Dec. 31, 1914.....	26,639.21	none	26,639.21
Jan. 1, 1915 to Feb. 9, 1915.....	21,800.13	100,000.00	none
Feb. 9, 1915 to Dec. 31, 1915.....	182,226.72	none	182,226.72
Jan. 1, 1916 to Feb. 8, 1916.....	39,684.03	200,000.00	21,910.75
Feb. 8, 1916 to Dec. 31, 1916.....	342,535.85	none	364,446.60
Jan. 1, 1917 to Feb. 13, 1917.....	52,045.48	300,000.00	116,492.08
Feb. 13, 1917 to Dec. 31, 1917.....	389,735.88	none	506,227.96
Jan. 1, 1918 to Feb. 12, 1918.....	36,213.41	300,000.00	242,441.37
Feb. 12, 1918 to June 22, 1918.....	112,089.12	100,000.00	254,530.49
June 22, 1918 to Oct. 2, 1918.....	87,946.85	80,852.20	261,625.14
Oct. 2, 1918 to Dec. 31, 1918.....	78,462.39	none	340,087.53
Jan. 1, 1919 to Feb. 11, 1919.....	58,549.87	300,000.00	98,637.40
Feb. 11, 1919 to Dec. 31, 19[illegible].....	462,686.79	none	561,324.19
Jan. 1, 1920 to Feb. 10, 1920.....	52,019.10	300,000.00	313,343.29
Feb. 10, 1920 to Dec. 31, 1920.....	423,955.68	none	737,298.87
Jan. 1, 1921 to Feb. 8, 1921.....	3,895.62	200,000.00	541,194.59
Feb. 8, 1921 to Dec. 31, 1921.....	33,522.87	none	574,717.46
Jan. 1, 1922 to Feb. 14, 1922.....	23,137.00	200,000.00	397,854.46
Feb. 14, 1922 to Dec. 31, 1922.....	168,794.98	none	566,649.44
Jan. 1, 1923 to Feb. 13, 1923.....	20,213.56	300,000.00	286,863.00
Feb. 13, 1923 to Dec. 31, 1923.....	151,366.63	none	438,229.63
Jan. 1, 1924 to Feb. 12, 1924.....	21,205.20	200,000.00	259,434.83
Feb. 12, 1924 to Dec. 31, 1924.....	163,582.99	none	423,017.82
Jan. 1, 1925 to Feb. 10, 1925.....	36,301.76	250,000.00	209,319.58
Feb. 10, 1925 to Dec. 31, 1925.....	294,951.83	none	504,271.41
Jan. 1, 1926 to Feb. 9, 1926.....	30,813.02	300,000.00	235,084.43
Feb. 9, 1926 to Dec. 31, 1926.....	257,565.25	none	492,649.68
Jan. 1, 1927 to Feb. 8, 1927.....	23,027.83	300,000.00	215,677.51
Feb. 8, 1927 to Dec. 31, 1927.....	198,160.57	none	413,838.08
Jan. 1, 1928 to Feb. 14, 1928.....	35,671.42	250,000.00	199,509.50
Feb. 14, 1928 to Dec. 31, 1928.....	261,049.92	none	460,559.42
Jan. 1, 1929 to Feb. 12, 1929.....	30,493.87	250,000.00	241,053.29
Feb. 12, 1929 to Oct. 10, 1929.....	174,250.71	975,000.00	none
Oct. 10, 1929 to Dec. 31, 1929.....	60,261.71	none	60,261.71
Jan. 1, 1930 to Feb. 11, 1930.....	22,143.03	225,000.00	none
Feb. 11, 1930 to Dec. 31, 1930.....	174,983.96	none	174,983.96

11

That of the dividend distributed by the Foster Lumber Company on February 10, 1914, in the amount of $100,000.00, [fol. 6] the sum of $42,377.71 was paid from earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913.

12

That of the dividend distributed by the Foster Lumber Company on February 9, 1915, in the amount of $100,000.00, the sum of $51,560.66 was paid from earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913.

13

That the dividends distributed by the Foster Lumber Company from 1916 to and inclusive of February 12, 1929, were distributed from earnings and profits accumulated subsequent to March 1, 1913.

14

That on October 12, 1929, the Foster Lumber Company distributed a dividend in the amount of $975,000.00. The earnings or profits accumulated from March 1, 1913 to October 12, 1929, and not distributed by the said corporation were insufficient from which to pay the distribution of October 12, 1929, and a large part of such distribution to-wit, $559,696.00, was paid from earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913.

15

The earnings of the Foster Lumber Company from October 10, 1929 to December 31, 1929, available for distribution were $60,261.71 and the earnings of the said corporation from January 1, 1930 to February 11, 1930, available for distribution were $22,143.03.

[fol. 7]

16

The plaintiff in this action contends that all of the earnings and profits of the Foster Lumber Company which had accumulated from March 1, 1913 to October 10, 1929, had been distributed on October 10, 1929, and that the only

earnings or profits available for distribution on February 11, 1930, were the amounts of $60,261.71 accumulated from October 10, 1929 to December 31, 1929, and $22,143.03 accumulated from January 1, 1930 to February 11, 1930, or a total amount of $82,404.74; and that of the dividend distributed by the Foster Lumber Company in the amount of $225,000.00 on February 11, 1930, the amount of $142,595.26 was paid from its earnings and profits accumulated, or increase in value of its property accrued, before March 1, 1913, which said amount of $142,595,26 was nontaxable to the recipients thereof in accordance with the relevant provisions of section 115 of the Revenue Act of 1928, 45 Stat. 822, which provides as follows:

"(a) Definition of Dividends.—The term 'dividend' when used in this title (except in section 203 (a) (4) and section 208 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.

(b) Source of Distributions.—For the purpose of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earn- [fol. 8] ings and profits accumulated after February 28, 1913, have been distributed, but any such tax free distribution shall be applied against and reduce the basis of the stock provided in Section 113."

17

The plaintiff further contends that of the amount of $23,250.00 reported by her in her income tax return for the calendar year 1930 as a taxable dividend received from the Foster Lumber Company from the said corporation's distribution on February 11, 1930, the amount of $14,734.84 was paid from the accumulated earnings and profits and increase in value of property accrued, before March 1, 1913, of the said Foster Lumber Company and is nontaxable in accordance with the above stated provisions of section 115 of the Revenue Act of 1928 as being distributed

from earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913.

18

That by deducting the amount of $14,734.84 from the amount of the dividend of $23,250.00 erroneously reported as taxable in the plaintiff's income tax return for 1930 and recomputing the amount of the income tax on the resultant corrected income, a tax liability of $109.68 and an overpayment of $740.60 are determined.

19

That the whole said sum of $740.60 is now wrongfully and unlawfully retained and held from the plaintiff without her consent and against her will by the United States of America.

[fol. 9] 20

Petitioner further represents that she is a citizen of the United States and has at all times borne true allegiance to the Government of the United States and has not in any way voluntarily aided, abetted or given encouragement to rebellion against said Government, and that she is the sole and absolute owner of the claim herewith presented; that she has made no transfer or assignment of said claim, or of any part thereof, and that petitioner is justly entitled to the amounts claimed herein from the United States after allowing all just credits and set-offs.

Petitioner, therefore, prays for judgment in her favor and against the United States of America for the said sum of $740.60, with interest thereon from March 12, 1931, together with the costs and disbursements of this action, and for such other and further relief as to this honorable court may seem just and proper.

C. Clifton Owens, Attorney for Plaintiff, American Security Building, Washington, D. C.

[fol. 10] *Duly sworn to by C. Clifton Owens. Jurat omitted in printing.*

[fol. 11] II. General Traverse—Filed May 26, 1934

And now comes the Attorney General, on behalf of the United States, and answering the petition of the plaintiff herein, denies each and every allegation therein contained; and asks judgment that the petition be dismissed.

Frank J. Wideman, Assistant Attorney General.

III. Substitution of Parties Plaintiff

On motion made therefor on July 8, 1936, and allowed by the court July 21, 1936, Benjamin B. Foster and Robert R. Todd, Executors of the Estate of Anna Foster Ford, deceased, were substituted as parties plaintiff.

IV. Argument and Submission of Case

On October 6 and 7, 1936, this case was argued and submitted on merits by Mr. Hugh C. Bickford, for plaintiffs, and by Mr. George H. Foster, for defendant.

[fol. 12] V. **Special Findings of Fact, Conclusion of Law and Opinion of the Court by Green, J.**—Filed December 7, 1936

Mr. Hugh C. Bickford for plaintiffs. Mr. C. Clifton Owens was on the briefs.

Mr. George H. Foster, with whom was Mr. Assistant Attorney General Robert H. Jackson, for defendant.

This case having been heard by the Court of Claims, the court, pursuant to the stipulation of the parties, makes the following

Special Findings of Fact

1. Anna Foster Ford, who was originally the plaintiff in this case, died March 30, 1936, and Benjamin B. Foster and Robert R. Todd, executors of her estate, have been substituted as plaintiffs.

2. March 12, 1931, the decedent filed her income tax return for the calendar year 1930 and reported therein a tax-

able net income of $29,697.29 and a tax liability thereon of $850.28, which she paid at the time of filing the return.

3. The decedent was, on February 11, 1930, the owner of record of 155 shares of a par value of $100 per share of the total of 1,500 shares of the capital stock of the Foster Lumber Company, a Missouri Corporation. She acquired this stock prior to March 1, 1913, at a cost less than the March 1, 1913, value, which March 1, 1913, value it is agreed was at least $2,000 per share. The Foster Lumber Company [fol. 13] on February 11, 1930, duly declared a cash dividend of 150 per cent of its capital stock payable on that date to all stockholders of record on that date. The decedent received during the calendar year 1930 the amount of $23,250.00 from the Foster Lumber Company in payment of the said dividend of February 11, 1930, on the 155 shares of stock owned by her. The entire amount of this dividend of $23,250.00 received by her during 1930 was included in the individual income tax return filed by her for that year as income and a tax paid thereon.

4. On July 18, 1932, the decedent filed with the Collector of Internal Revenue at Kansas City, Missouri, a claim for the refund of $712.01 of the income tax paid by her for the year 1930. This claim was predicated on the basis that of the dividend of $23,250.00 received by her from the Foster Lumber Company during 1930 and reported as taxable in its entirety the amount of $14,754.22 was paid out of surplus accumulated or appreciation of land and timber arising before March 1, 1913, and was to that extent and for that reason exempt from tax. The Commissioner of Internal Revenue rejected the said claim for refund on September 21, 1933.

5. The Foster Lumber Company was a Missouri Corporation which had issued 2,000 shares of common stock having a par value of $100 each. It was formed for the purpose of manufacturing, buying, and selling lumber, building material, and merchandise generally; also for buying, selling, and leasing lands. On March 1, 1913, the earnings or profits accumulated and increase in value of property owned by the company were in excess of $3,725,000.

6. The following tabulation sets forth with reference to the Foster Lumber Company, in column "A" the period

involved, in column "B" the amount of the earnings, or profits for that period, in column "C" the amount of the dividend distributed on the last day of the indicated period and in column "D" the balance of the earnings, or profits accumulated subsequent to February 28, 1913:

[fol. 14]

"A" Period	"B" Earnings or Profits	"C" Distributions	"D" Balance of Earnings or Profits Accumulated Since February 28, 1913
Mch. 1, 1913 to Dec. 31, 1913	$54,488.12	none	$54,488.12
Jan. 1, 1914 to Feb. 10, 1914	3,322.90	$100,000.00	none
Feb. 10, 1914 to Dec. 31, 1914	26,998.60	none	26,998.60
Jan. 1, 1915 to Feb. 9, 1915	21,800.13	100,000.00	none
Feb. 9, 1915 to Dec. 31, 1915	182,226.72	none	182,226.72
Jan. 1, 1916 to Feb. 8, 1916	38,890.35	200,000.00	21,117.07
Feb. 8, 1916 to Dec. 31, 1916	335,685.13	none	356,802.20
Jan. 1, 1917 to Feb. 13, 1917	52,944.91	300,000.00	109,747.11
Feb. 13, 1917 to Mch. 16, 1917	38,169.59	50,000.00	97,916.70
Mch. 16, 1917 to Dec. 31, 1917	358,301.60	none	456,218.30
Jan. 1, 1918 to Feb. 12, 1918	34,852.96	300,000.00	191,071.26
Feb. 12, 1918 to Jun. 22, 1918	107,878.22	100,000.00	198,949.48
Jun. 22, 1918 to Oct. 2, 1918	84,642.91	80,852.20	202,740.19
Oct. 2, 1918 to Dec. 31, 1918	75,514.77	none	278,254.96
Jan. 1, 1919 to Feb. 11, 1919	55,306.55	300,000.00	33,561.51
Feb. 11, 1919 to Dec. 31, 1919	437,056.62	none	470,618.13
Jan. 1, 1920 to Feb. 10, 1920	51,764.03	300,000.00	222,382.16
Feb. 10, 1920 to Dec. 31, 1920	421,876.82	none	644,258.98
Jan. 1, 1921 to Feb. 8, 1921	3,269.75	200,000.00	447,528.73
Feb. 8, 1921 to Dec. 31, 1921	28,137.05	none	475,665.78
Jan. 1, 1922 to Feb. 14, 1922	25,585.23	200,000.00	301,251.01
Feb. 14, 1922 to Dec. 31, 1922	186,655.92	none	487,906.93
Jan. 1, 1923 to Feb. 13, 1923	19,938.46	300,000.00	207,845.39
Feb. 13, 1923 to Dec. 31, 1923	149,306.62	none	357,152.01
Jan. 1, 1924 to Feb. 12, 1924	20,649.83	200,000.00	177,801.84
Feb. 12, 1924 to Dec. 31, 1924	159,298.68	none	337,100.52
Jan. 1, 1925 to Feb. 10, 1925	36,057.51	250,000.00	123,158.03
Feb. 10, 1925 to Dec. 31, 1925	292,967.27	none	416,125.30
Jan. 1, 1926 to Feb. 9, 1926	29,521.05	300,000.00	145,646.35
Feb. 9, 1926 to Dec. 31, 1926	246,765.70	none	392,412.05
Jan. 1, 1927 to Feb. 8, 1927	25,195.83	300,000.00	117,607.88
Feb. 8, 1927 to Dec. 31, 1927	216,816.76	none	334,424.64
Jan. 1, 1928 to Feb. 14, 1928	34,957.28	250,000.00	119,381.92
Feb. 14, 1928 to Dec. 31, 1928	255,823.73	none	375,205.65
Jan. 1, 1929 to Feb. 12, 1929	30,587.52	350,000.00	155,793.17
Feb. 12, 1929 to Oct. 10, 1929	174,785.81	975,000.00	none
Oct. 10, 1929 to Dec. 31, 1929	60,446.75	none	In issue
Jan. 1, 1930 to Feb. 11, 1930	22,311.42	225,000.00	In issue
Feb. 11, 1930 to Dec. 31, 1930	176,314.60	none	In issue

7. At the time of the declaration and payment by the Foster Lumber Company of the dividend of $100,000.00 on February 10, 1914, its earnings and profits accumulated subsequent to February 28, 1913, were but $57,811.02.

8. At the time of the declaration and payment by the Foster Lumber Company of the dividend of $100,000.00 on

February 9, 1915, its earnings and profits accumulated subsequent to February 28, 1913, and not distributed were but $48,798.73.

9. The dividends distributed by the Foster Lumber Company from 1916 to, and inclusive of, February 12, 1929, were distributed from earnings and profits accumulated subsequent to February 28, 1913.

[fol. 15] 10. The capital stock of the Foster Lumber Company has always been owned by members of the Foster family. Three members of the family who had removed to California were stockholders in the corporation, and in order that they might retire from ownership of and participation in the affairs of the corporation and also that a rearrangement of interests might be effected it was decided to retire and cancel 500 shares of the company's capital stock. Accordingly, under date of July 20th, 1929, the Foster Lumber Company by formal written notice to all of its stockholders requested that each of them notify it if they were in favor of a reduction in the capital stock of the company from $200,000.00 to $150,000.00 by the acquisition and cancellation by the company of 500 shares of its outstanding capital stock of 2,000 shares from the therein named stockholders in the proportions and for the amounts set forth in that letter.

11. On October 1, 1929, a meeting of the stockholders of the Foster Lumber Company was held and a resolution adopted providing for the reduction of the capital stock of the company from $200,000 divided into 2,000 shares to $150,000 divided into 1,500 shares, and on October 8, 1929, the company having complied with the laws of the State of Missouri providing for the decrease of capital stock, the Secretary of State certified to the decrease therein to the amount of $150,000.

12. On October 10, 1929, the Foster Lumber Company distributed $1,025,000 in cash to its stockholders for 500 shares of its capital stock retired on that date pursuant to the proceedings above recited. On the books of the corporation, $975,000 of the amount distributed was charged to surplus and $50,000 to the capital stock account. The stock retired was immediately canceled. This distribution was on the basis of $2,050 per share and subsequently it was agreed between the stockholders and the defendant that the

value of the stock on March 1, 1913, was $2,050 per share and that no taxable income was determined as arising out of the retirement of the stock in 1929.

13. On February 12, 1929, and immediately after the payment of the cash dividend made on that date in the amount of $250,000.00 the remaining balance of earnings and profits [fol. 16] accumulated by the Foster Lumber Company since February 28, 1913, was $155,793.17. The earnings and profits of that corporation for the period from February 12, 1929, to October 10, 1929, were $174,785.81.

14. The earnings and profits of the Foster Lumber Company on October 10, 1929, prior to the distribution of $1,025,000.00 on that date, which had been accumulated since February 28, 1913, were $330,578.98.

15. The accumulated earnings or profits of the Foster Lumber Company for the period from October 10, 1929, to February 11, 1930, and prior to the cash distribution of $225,000.00 on the latter date by that company were $82,758.17.

Conclusion of Law

Upon the foregoing special findings of fact, which are made part of the judgment herein, the court decides, as a conclusion of law, that the plaintiffs are not entitled to recover, and it is therefore ordered that their petition be dismissed.

Judgment is rendered against the plaintiffs in favor of the United States for the cost of printing the record in this case, the amount thereof to be ascertained by the clerk and collected by him according to law.

Opinion

Green, Judge, delivered the opinion of the court:

The plaintiffs, claiming that the decedent in her lifetime overpaid her taxes for the year 1930, bring this suit to recover the alleged overpayment, being $740.60 together with interest from March 12, 1931. There is no dispute as to the facts.

For the calendar year 1930 the decedent filed a return stating her taxable income to be $29,697.29 and paid the tax thereon. Included in decedent's reported income was the sum of $23,250 received from the Foster Lumber Company

as dividends on 155 shares of stock of that company owned by her. This was out of a dividend of $225,000 declared on February 11, 1930.

[fol. 17] Plaintiffs claim that $14,754.22 included in the dividend of $23,250 was paid by the company out of surplus accumulated prior to March 1, 1913, and hence was exempt from tax. The Commissioner of Internal Revenue rejected this claim and the decedent having filed a claim for refund which was also denied, brought this suit.

The Foster Lumber Company was organized in 1896 and up to 1929 its capital stock consisted of 2,000 shares of the par value of $100 per share. On March 1, 1913, its earnings and surplus were in excess of $3,725,000. On October 10, 1929, having determined to retire 500 shares of the capital stock, the company paid in cash to its stockholders $1,025,000 and 500 shares of the stock were surrendered to the company for cancellation. Of this sum $975,000 was charged to surplus and $50,000 was charged to capital stock.

The plaintiffs rely on section 115 (b) of the revenue act of 1928 which provides that—

> For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits.

It is contended that this provision is controlling here and that consequently the distribution made on October 10, 1929, must be treated as made out of earnings or profits accumulated since February 28, 1913, to the extent thereof. As the amount of such earnings remaining undistributed at that time was only $330,578.98, it is plain that if this rule is applied the distribution would more than absorb all of this amount leaving nothing to be carried over to the next year.

In the interval from October 10, 1929, to February 11, 1930, when $225,000 was distributed, the corporation accumulated $82,758.17 and plaintiffs claim that this was all which was distributed on the date last mentioned out of earnings and profits accumulated since February 28, 1913. If this is correct, the remainder of the dividend, $142,241.83, was not subject to income tax when it came into the hands of the stockholders and the Commissioner erred in holding to the contrary and in refusing to allow the decedent's claim for a proportionate reduction in her income tax for that year.

[fol. 18] The defendant, on the other hand, contends that the distribution made in 1929 constituted an exception to the general rule expressed in section 115 (b) and is covered by a provision in 115 (c) which reads as follows:

In the case of amounts distributed in partial liquidation * * * the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of subsection (b) of this section for the purpose of determining the taxability of subsequent distributions by the corporation.

It will be seen that the ultimate issue between the parties is whether the distribution of 1929 was "properly chargeable to capital account."

In determining the question thus presented the nature of the distribution must first be considered.

Clearly the distribution was not a dividend, either in the special sense that the word is used in the statute as defined in section 115 (a), or in its meaning as generally used, which is somewhat broader. The definition set out in the statute was evidently inserted to make sure that there could be no claim that a distribution made out of profits was not a dividend. The distinction between a dividend and such a distribution as is made in the case before us is quite plain. When a dividend is made, the stockholder receives something but pays nothing. In the case at bar, the stockholder received money from the corporation but gave what may be considered as full value for what she received. Neither the stockholder nor the corporation had gained by the transaction. We think that if profits were distributed, as is now claimed by the plaintiffs, the stockholder would not have been required to pay for what she received. What the corporation turned over to the stockholders was the value of their stock which appears to be the same as on March 1, 1913. This is treated by the law as a basis of the determination of gain or loss to the stockholder in the transaction, and we think it is so treated on the ground that earnings or profits accumulated prior to that date constituted for tax purposes the capital of the taxpayer. When the stockholders obtained the March 1, 1913, value of their stock, it was the realization of capital, and was properly chargeable to capital account.

[fol. 19] A consideration of the purpose of section 115 (c) of the act of 1928 and the reports made by the committees of the House and Senate when it first became a part of the revenue law supports the view above expressed. As the law originally stood, the plan devised in the case before us could be carried out so that the earnings and profits accumulated since 1913 would be distributed tax free. The general provisions of 115 (b), which were in the former act, would have required the distribution to be treated as made out of earnings or profits accumulated after February 28, 1913, and the distribution would be properly chargeable to surplus and paid out of such profits with the result that the distribution made October 10, 1929, absorbed all of the earnings and profits to that date. Obviously this would enable the stockholders to escape taxation although they had received earnings and profits which had accumulated since February 28, 1913. To prevent this avoidance of taxes, what is now section 115 (c) of the revenue act of 1928 was inserted in the revenue act of 1924 as section 201 (c). This new provision stated an exception to section 115 (b), namey a case where the distribution was "properly chargeable to capital account." When the 1924 act was reported, the reports on the bill made by both the Senate and House Committees contained the following statement:

> The theory of liquidating dividends is extended to distributions in partial liquidation. If a corporation retires a portion of its capital stock, the transaction is treated, from the point of view of the stockholder, as a sale of his stock. If the corporation distributes an amount in partial retirement of its capital stock, the amount thereof is *to be considered as a return of capital* and taxable only if, as, and to the extent that it exceeds the basis of the stock. [Italics ours.]

In the case before us, the corporation distributed an amount in partial retirement of its capital stock and, as stated in the report, this is "considered as a return of capital." Money paid out in making a return of capital is "properly chargeable to capital account." It is true that the reports presented the matter "from the point of view of the stockholder", but the principle is the same when applied to the corporation. The distribution came within

[fol. 20] the provisions of 115 (c), being properly chargeable to capital account, and consequently was not to be considered as a distribution of profits under 115 (b).

If the distribution of 1929 was charged to capital account, as it should be according to what we have held above, the profits which had accrued since 1913 and then on hand would not be depleted thereby. When the 1930 distribution was made, then, under the provisions of 115 (b), it would be paid out of these profits to the extent thereof. When the decedent received her share of these profits, the Commissioner rightly held that she was taxable thereon.

The petition must be dismissed and it is so ordered.

Whaley, Judge; Williams, Judge; Littleton, Judge; and Booth, Chief Justice, concur.

[fol. 21] VI. JUDGMENT

At a Court of Claims held in the City of Washington on the 7th day of December, A. D., 1936, judgment was ordered to be entered as follows:

Upon the special findings of fact, which are made part of the judgment herein, the court decides, as a conclusion of law, that the plaintiffs are not entitled to recover.

It is Therefore Adjudged and Ordered that the plaintiffs' petition be and the same is hereby dismissed.

VII. PROCEEDINGS AFTER ENTRY OF JUDGMENT

On February 5, 1937, the plaintiffs filed a motion for a new trial.

On April 5, 1937, the Court, by Green, J., filed the following opinion on said motion:

[fol. 22] VIII. OPINION BY GREEN, J., ON PLAINTIFFS' MOTION FOR NEW TRIAL—Filed April 5, 1937

GREEN, Judge, delivered the opinion of the court:

In the argument in support of the motion for new trial it is strenuously insisted that the decision of the court is contrary to the rule laid down in a decision by the Supreme Court, one made by the Circuit Court of Appeals for the Second Circuit, and also another by the Board of Tax Ap-

peals. As no reference was made to these cases in the original opinion, it is thought best to show why the court did not mention them.

Special reliance is placed upon the case of Helvering v. Canfield, 291 U. S. 163, and it will be admitted that the opinion in the case at bar is not in accord with some statements found in the opinion of the Supreme Court in that case, but the reason is plain. We have before us a different act imposing a different rule. The decision in the case just cited was made under the provisions of section 201 (b) of the revenue act of 1921[1]; the holding in the case at bar is [fol. 23] based upon the special provision contained in the act of 1924 [201 (c)] which was inserted for the purpose of making an exception to the provisions of the law that controlled the Canfield case, supra. In fact it could have been inserted for no other purpose and is otherwise meaningless. Counsel quote from the opinion of the Supreme Court in the last named case the following:

> Nor is it important that the accumulated profits, as they stood on March 1, 1913, constituted capital of the company as distinguished from the gains or income which the company subsequently realized.

Clearly it was not as the statute then stood, but it is now in such cases as the one we have before us. Section 201 (c) of the 1924 act provided that—

> (c) Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of

---

[1] The changes made in the revenue acts have led to some confusion in applying the statutes. The 1918 act contained a provision that "amounts distributed in the liquidation of a corporation shall be treated as payment in exchange for stock or shares." For some reason this provision was omitted in the 1921 act under which the Canfield case was decided; but it was restored in the 1924 act with some amplification as shown in the quotation from that statute. It is still in force under a different section number. In the 1924 act the part material to the case under consideration was designated as section 201 (a), (b), and (c). In the 1928 act, it is marked section 115 (a), (b), and (c).

a corporation shall be treated as in part or full payment in exchange for the stock. * * * In the case of amounts distributed in partial liquidation * * * the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of subdivision (b) of this section for the purpose of determining the taxability of subsequent distributions by the corporation.

In the case at bar it is conceded that there was a distribution in partial liquidation, which the statute says "shall be treated as in part or full payment in exchange for the stock", and further that if it is "properly chargeable to capital account" it shall not be considered as "within the meaning of subdivision (b)" upon which the plaintiffs rely.

In support of their argument that the distribution of 1929 was not "properly chargeable to capital account", counsel for plaintiffs quote further from the opinion of the Supreme Court—

When a corporation continued in business after March 1, 1913, the dividends it later declared and paid to its stockholders, whether out of current earnings or from profits accumulated prior to that date, constituted income to the stockholders, and not capital, and were taxable as income if the Congress saw fit to impose the tax.

[fol. 24] But in the Canfield case from which this quotation was taken, the Supreme Court was applying the 1921 act to "dividends." In the instant case we must apply the 1924 statute to an "amount distributed in partial liquidation" which, like amounts distributed in complete liquidation, to the extent of the distribution must be "treated as in full payment in exchange for the stock." Payments for stock are chargeable to capital account.

The case of John B. Stewart v. Commissioner, 29 B. T. A. 809, also, in our opinion, has no application. It is necessarily taken out of the special provision above quoted by the fact that the Board held that the distribution then under discussion was not "a distribution in partial liquidation" but a dividend and controlled by subdivision (b) of section 115 of the act of 1928. The plaintiffs also cite the case of Horrmann v. Commissioner, 34 B. T. A. 1178, wherein it is said that "the 'capital account' referred to by the statute

is not increased by the issuance of a nontaxable stock dividend, but comprises only the paid-in capital." We are not disposed to agree with the construction which counsel place upon this statement but it is immaterial because the instant case does not involve any stock dividend and the Supreme Court has held that stock dividends are not a distribution. The case last cited is quite complicated in its facts and to review it fully would unduly extend this opinion. We agree with the holding made in the opinion that "normally the redemption of stock is a return of capital", and also that "as an accounting matter the whole would be charged against capital", but are not disposed to agree as to all that is said in the opinion with reference to the meaning of the statute under discussion. The case of Harter v. Helvering, 79 Fed. (2d) 12, did not involve a "distribution in partial liquidation" and consequently what is said therein has no application here.

The case of Hellmich v. Hellman,[2] 276 U. S. 233, is not cited by either party. Possibly this failure is due to the fact that the ultimate question in the case is not the one which is now before this court, but in the course of its opinion [fol. 25] the court in effect ruled on the matter now in controversy. In this case it was held that—

> * * * the general definition of a dividend in § 201 (a) was not intended to apply to distributions made to stockholders in the liquidation of a corporation, but that it was intended that such distributions should be governed by § 201 (c), which, dealing specifically with such liquidation, provided that the amounts distributed should "be treated as payments in exchange for stock" * * *.

In Klein on Income Taxation, par. 10:18 (a), it is said that—

> Under this rule [as stated in Hellmich v. Hellman, supra] it does not matter that part of the liquidating dividend came from accumulated earnings. The transaction is treated in its entirety as a capital transaction.

---

[2] This case was decided under the 1918 act. See note 1 for the provision therein with reference to amounts distributed in liquidation.

Being a capital transaction, the payments made would be chargeable to capital account and under the statute could not be considered in "determining the taxability of subsequent distributions."

The Board of Tax Appeals on March 15, 1937, entered a memorandum opinion in the case of Craig, Executor, v. Commissioner, which involved the same facts and pertained to the same estate as the case at bar. The decision rendered was in accordance with the contentions of the plaintiffs made in the case now before this court and was contrary to the views which we have expressed above. As the reasoning upon which this opinion was based is not expressed, we can only say that we do not concur.

Our conclusion is that the motion for new trial must be overruled, and it is so ordered.

Whaley, Judge; Williams, Judge; Littleton, Judge; and Booth, Chief Justice, concur.

[fol. 26] IX. Order Overruling Plaintiffs' Motion for New Trial

It is Ordered this 5th day of April, A. D., 1937, that the plaintiffs' motion for new trial be and the same is hereby overruled.

[fol. 27] Clerk's certificate to foregoing transcript omitted in printing.

Endorsed on cover: File No. 41,670. Court of Claims. Term No. 189. Benjamin B. Foster and Robert R. Todd, Executors of the Estate of Anna Foster Ford, Deceased, petitioner, vs. The United States. Petition for a writ of certiorari and exhibit thereto. Filed July 2, 1937. Term No. 189, O. T., 1937.

[fol. 28] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed October 11, 1937

The petition herein for a writ of certiorari to the Court of Claims is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Mr. Justice Black took no part in the consideration and decision of this application.

(2417)

Office - Supreme Court, U. S.
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JUL 2 1937
CHARLES ELMORE CROPLEY
CLERK

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1937

No. 189

BENJAMIN B. FOSTER AND ROBERT R. TODD, EXECUTORS OF THE ESTATE OF ANNA FOSTER FORD, DECEASED,
Petitioner,

vs.

THE UNITED STATES.

PETITION FOR WRIT OF CERTIORARI TO THE COURT OF CLAIMS AND BRIEF IN SUPPORT THEREOF.

HUGH C. BICKFORD,
R. KEMP SLAUGHTER,
C. CLIFTON OWENS,
Counsel for Petitioner.

INDEX.

Subject Index.

	Page
Petition for writ of certiorari	1
Question presented	1
Summary statement of the matter involved	2
Reasons for granting writ	2
Prayer for writ	9
Brief in support of petition	11
Opinions below	11
Jurisdiction	11
Facts	11
The Law	12
Specifications of error	12
Argument	13
Conclusion	23
Appendix A—Revenue Act of 1928, Sec. 115	24
Appendix B—Opinion of Board of Tax Appeals in Craig v. Commissioner	25

Table of Cases Cited.

Craig v. *Commissioner* (see Apendix B)	3, 16, 22, 25
Eisner v. *Macomber*, 252 U. S. 189	7, 9
Glenmore Securities Corp. v. *Commissioner*, 62 F. (2d) 780	4, 16
Harter v. *Helvering*, 79 F. (2d) 12	4, 16, 20
Hellmich v. *Hellman*, 276 U. S. 233	21
Helvering v. *Canfield*, 291 U. S. 163	8
Horrmann v. *Commissioner*, 34 B. T. A. 1178	3, 16, 20
Lynch v. *Hornby*, 247 U. S. 339	9
Stewart v. *Commissioner*, 29 B. T. A. 809	3, 16, 20
U. S. v. *Safety Car Heating and L. Co.*, 297 U. S. 88	8
Willcuts v. *Milton Dairy Co.*, 275 U. S. 215	7, 9

Statutes Cited.

	Page
Judicial Code, Sec. 180 and 240, as amended by the Act of February 13, 1925	11
Revenue Act of 1921, Sec. 201(b)	8, 15
Revenue Act of 1924, Sec. 201(c)	8, 18
Revenue Act of 1928, Sec. 115	2, 3, 24
Revenue Act of 1928, Sec 115(a)	3, 14
Revenue Act of 1928, Sec. 115(b)	4, 8, 12, 13, 14
Revenue Act of 1928, Sec. 115(c)	3, 6, 8, 12, 13, 14

Additional Authorities Cited.

Senate Finance Committee Report No. 398, p. 12, 68th Congress, 1st Session	9
Geier & Mautner, Practical Corporation Accounting, 1930, p. 342	14

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1937

No. 189

BENJAMIN B. FOSTER AND ROBERT R. TODD, EXECUTORS OF THE ESTATE OF ANNA FOSTER FORD, DECEASED,
Petitioner,

vs.

THE UNITED STATES.

PETITION FOR WRIT OF CERTIORARI.

This petition seeks writ of certiorari to the United States Court of Claims to review judgment in Benjamin B. Foster and Robert R. Todd, Executors of the Estate of Anna Foster Ford, deceased, *vs.* The United States of America, No. 42642. Original opinion was reported at 17 Fed. Supp. 191; (R. 11) supplemental opinion on motion for new trial was reported at 18 Fed. Supp. 790, (R. 15). On April 5, 1937, motion for new trial was overruled (R. 19).

Question Presented.

A corporation, on October 10, 1929, made a distribution of its capital and surplus in the amount of $1,025,000 in liquidation and cancellation of 500 shares ($50,000 par value) of its total outstanding common capital stock of 2,000 shares ($200,000 par value). It charged $50,000 of this distribution to its capital stock account; the balance of $975,000 was charged against surplus.

Did the court below err in holding that the amount of earned surplus ($975,000) distributed in excess of the paid-in capital ($50,000) should be charged entirely against earnings of the corporation accumulated *prior* to March 1, 1913, instead of, in part, against most recently accumulated earnings in the amount of $330,578.98 accrued subsequent to February 28, 1913 (Sec. 115, Rev. Act of 1928).

This question affects the taxable status of a second dividend distribution in the year 1930 (the taxable year here involved), by a determination whether the earnings in the amount of $330,578.98 are available for that second dividend, or were exhausted by the first.

Summary Statement of the Matter Involved.

The special findings of fact (R. 7-11), based on written stipulation, established that the decedent, on February 11, 1930, was the owner of 155 shares of capital stock of the Foster Lumber Company. On such date she received a dividend of $23,250, part of a total distribution of $225,000 (R. 8). Whether this dividend is taxable in whole or only to the extent of part, is dependent on the effect of a prior distribution, October 10, 1929, in partial liquidation of shares of the corporation stock.

Summarizing, the facts are:

On October 10, 1929, the Foster Lumber Company had:	
Capital Stock outstanding at March 1, 1913—2,000 shares at paid-in par value (R. 10) of	$200,000.00
Surplus	
Undistributed earnings accumulated prior to March 1, 1913 (R. 8, 9)	3,725,000.00
Undistributed earnings accumulated *since* March 1, 1913 (R. 11)	330,578.98

On October 10, 1929, Foster Lumber Company distributed $1,025,000 in cancellation and liquidation of 500 shares,

or one-fourth of its capital stock. On its books $50,000 of this amount was charged against Capital Stock Account, the balance of $975,000 was charged against surplus (R. 10). The court below held that the distribution of $975,000 should be applied against the earnings of $3,725,000 accrued to March 1, 1913, that none of the distribution should be charged against most recently accumulated earnings since 1913. Had the Court held that the distribution of $975,000 should have applied to the extent of the most recently accumulated earnings of $330,578.98, these earnings would have been exhausted and accordingly would not be available for subsequent dividend distributions. In that event the earnings available for subsequent dividend distribution on February 11, 1930, would be only the amount accumulated between October 10, 1929, and February 11, 1930, the sum of $82,758.17 (R. 12).

Reasons for Granting Writ.

1. *The decision below is in conflict with and confuses the law established by every other decision rendered under Section 115 of the Revenue Acts after 1928 and Section 201 of prior Acts.*

a. *Board of Tax Appeals.*—The Board has considered Section 115(c) in its reference to the remainder of Section 115, each time consistently holding that a partial liquidation shall be charged in the following precedence:

First. Against the capital account, that is, the capital paid in, to the extent thereof.

Second. Against the most recently accumulated earnings since March 1, 1913, to the extent thereof.

Third. Against earnings accumulated prior to March 1, 1913.

John B. Stewart v. *Commissioner*, 29 B. T. A. 809;
Horrmann v. *Commissioner*, 34 B. T. A. 1178;
Craig, Executor, v. *Commissioner*, Memorandum Opinion, March 15, 1937, not reported (Attached hereto as Appendix B for ready reference).

The court below admits its decision is in direct conflict with these decisions. In fact, the *Craig* case, *supra,* actually involves another stockholder of the Foster Lumber Company who participated in exactly the same dividends paid to decedent and here involved. There is, therefore, presented the unusual situation of a direct conflict in what is essentially the *same case,* between the Board of Tax Appeals and the court below.

b. *The Federal Courts.*—In *Harter* v. *Helvering,* 79 F. (2d) 12 (C. C. A. 2), a corporation retired its preferred stock in 1926. In 1927 a dividend was paid.* The court held that it was immaterial whether the first distribution was an ordinary distribution under paragraph (b) or a liquidation under paragraph (f) of Section 115; it "must be marshalled first against the earnings after February 28, 1913, for it more than exhausted them. What was left was capital or earlier earnings." As the facts were manifestly the same as here, the decision below is in conflict. In *Glenmore Securities Corp. v. Commissioner,* 62 F. (2d) 780 (C. C. A. 2), the taxpayer was a member of a syndicate in which he invested $40,000. In 1925, 1926 and 1927 the taxpayer's proportionate share was (24 B. T. A. 700, for these facts):

1925	$40,864
1926	12,712
1927	5,977

Only the amount earned in *1925* was actually distributed in liquidation of the original investment. The Commissioner held the syndicate a partnership and taxed the petitioner on distributive shares. The Court of Appeals reversed,

* Several non-taxable reorganizations complicate the facts in *Harter* v. *Helvering,* but as they were held to "carry through" without change in nature of capital or surplus, we believe the ultimate facts are as simple as stated.

held the syndicate was not a partnership, and then considered what the taxable status should be:

> "Assuming, as we must, that the syndicate was not a partnership, we are to decide whether nevertheless the taxpayer has shown that it was over-assessed.
>
> "Two possibilities are open; the syndicate may have been an association, *taxable as a corporation;* or it may have been a trust. In the first case the *statute ascribes the first payments upon partial distribution to the latest earnings, until they are exhausted.* Section 201 (b) (c) of the Act of 1924 (26 U. S. C. A. par. 932 (b, c)). The decisions cover such a situation, and would have allowed an assessment of the whole payment as income, provided it did not impair the capital, as it did not. McCaughn *v.* McCahan, 39 Fed. (2d) 3 (C. C. A. 3); Leland *v.* Commissioner, 50 Fed. (2d) 523 (C. C. A. 1); Phelps *v.* Commissioner, 54 Fed. (2d) 289, 292 (C. C. A. 7); Christopher *v.* Burnett, 60 App. D. C. 365, 55 Fed. (2d) 527."

Thus, the Second Circuit holds that the consistent holding of "the decisions" is to ascribe earnings upon partial liquidation to the latest earnings (*i. e.*, those subsequent to 1913) until exhausted.

There is, therefore, direct conflict between the court below, on the one hand, and the Board of Tax Appeals and the Circuit Court of Appeals for the Second Circuit on the other, a conflict which is expressly admitted by the court below as to the decision of the Board in the same case (R. 19).

2. *The decision below is utterly inconsistent with the plain provisions of the Revenue Act.*

The decision below is based upon the syllogistic reasoning that earnings existing at March 1, 1913, were capital and, therefore, that all of the dividend in partial liquidation must be considered as a charge against "capital account"

and none against earnings and profits. This is directly contrary to the language of the statute; Section 115(c), where material, states:

> "In the case of amounts distributed in partial liquidation * * * the *part* of such distribution which is properly chargeable to capital account shall *not* be considered a distribution of earnings or profits within the meaning of sub-section (b) of this Section for the purpose of determining the taxability of subsequent distributions by the corporation."

This sentence does not refer to earnings and profits before March 1, 1913, alone or earnings after such date. It contra-distinguishes capital account from *all* earnings or profits, a common business practice and accounting custom. Manifestly, if only "*part*" of the partial liquidation is to be "capital account", the whole must include some other part consisting of "earnings or profits". After the "*part*" is charged, there must be left *some* "earnings or profits" within the meaning of subdivision (b) or the language of the sections means nothing. The court below, on the contrary, holds that *none* of the distribution is "earnings or profits" within the meaning of subsection (b).

Furthermore, the decision below conflicts directly with the express prohibition of the statute. Subdivision (b) says:

> "The part * * * which is properly chargeable to capital account *shall not* be considered a distribution of earnings or profits "within * * * sub-section (b)."

Subsection (b) refers both to "earnings or profits" *before* 1913 and "earnings or profits" *after* 1913.

If the statute is observed, the amount charged to "capital account" shall *not* be considered a distribution of *earnings or profits* either before or after 1913. The court below holds that the entire surplus of $925,000 distributed constitutes

earnings or profits *before* 1913, which the statute directly says "shall not" be done.

The difficulty of the court below seems to be that it confuses the terms "dividends" and "earnings or profits" used in Section 115, both of which are expressly defined.* Subsection (a) defines "dividends" as being only "earnings or profits accumulated *after* February 28, 1913." Subsection (b) explains "earnings or profits" as including surplus, *both* before *and* after. Subsection (c) provides for the "part" which shall not be either, that is the "capital account". Obviously, where a corporation distributes $50,000 of its capital invested and $925,000 of its surplus, the surplus must be charged against either the earnings *before* or the earnings *after* 1913. Since, therefore, the statute provides (c), that the "*part* chargeable to capital account" shall not be chargeable to *either*, the "part" must mean the capital stock account because the balance has to be charged against earnings or profits to give the section any logical, ordinary meaning.**

Thus, logically construed, the section means that the capital investment distributed, of $50,000 shall be "capital account", shall not be charged to "earnings or profits" but that the surplus distributed shall be so charged according to the precedence established by sub-section (b); that is, the most recently accumulated earnings shall be distributed first.

3. *The decision below throws into confusion the long standing rule that all earnings and profits are income, subject to tax, as distinguished from paid-in capital.*

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* The Court several times uses the term "dividends" when it means "distributions of earnings or profits" (R. 13, 18).

** Cf. *Willcuts* v. *Milton Dairy Co.*, 275 U. S. 215, 218; for distinction between capital and earnings and profits. *Eisner* v. *Macomber*, 252 U. S. 189, 209, 210, 211, discusses ordinary accounting usage.

It is significant that the court below referred to no cases in support of its opinion but merely sought to distinguish those in conflict therewith. The court below held that earnings accumulated at March 1, 1913, "constituted for tax purposes the capital of the taxpayer" (R. 13). The court below thus becomes subject to the confusion between capital and exempt earnings referred to in *U. S.* v. *Safety Car Heating and L. Co.*, 297 U. S. 88, 95, 96.

In *Helvering* v. *Canfield*, 291 U. S. 163, this Court said:

> *"When a corporation continued in business after March 1, 1913, the dividends it later declared and paid to its stockholders, whether out of current earnings or from profits accumulated prior to that date, constituted income to the stockholders, and not capital and were taxable as income if the Congress saw fit to impose the tax* (*Lynch* v. *Hornby*, 247 U. S. 339). The provision of the Act of Congress under consideration was a 'concession to the equity of stockholders' with respect to receipts as to which they had no constitutional immunity. There is no question here of the receipt of 'capital'." (Italics supplied.)

Such prior earnings not being capital, but tax-free income, the syllogistic reasoning by which the court below first holds such earnings to be "capital" and, then, for that reason alone, "capital account", necessarily fails.

The court below attempts to distinguish the *Canfield* case by stating that such case arose under Section 201(b) of the Revenue Act of 1921 (a counterpart of 115(b) in the Revenue Act of 1928) and that the 1921 Act contained no provision similar to Section 115(c) of the 1928 Act. But it is clear Congress meant no change in the conclusive presumption inherent in all the distribution sections of the Act, that whenever earnings and profits are to be distributed the earnings *after* March 1, 1913, shall be distributed *first*. Thus, when 201(c), the antecedent of 115(c)), was first

added in the 1924 Act the Senate Finance Committee said of the last sentence of Section 201(c) here involved:

> No similar provision is contained in the existing law, *although the provisions of the bill represent what is probably the correct construction of the existing law and unquestionably what is in accord with business practice.* (68th Congress, 1st Session; Report No. 398, p. 12.)

Accordingly, Congress was not changing the meaning of the tax statute as stated by the court below, but simply making clearer the accepted concept that distinguishes earnings and profits from capital paid in. *Lynch* v. *Hornby*, 247 U. S. 339; *Eisner* v. *Macomber*, 252 U. S. 189, 209, 210; *Willcuts* v. *Milton Dairy Co.*, 275 U. S. 215, 218. The decision below sets aside this well accepted rule and throws into confusion the taxable status of dividends which are not an insignificant part of our national income. In 1936 the portion of the national income paid out in dividends amounted to $4,573,000,000 which compares with $5,969,000,000 paid out in 1929 and with $2,213,000,000 paid out in 1933.* With the added effect of the corporate surtax on undistributed profits it may be expected that the national income from dividends will continue to increase. Questions, such as the one here at issue, involving the taxability of dividends therefore become of widespread importance, both to taxpayers and to the Government.

WHEREFORE your petitioner prays that a writ of certiorari be issued out of and under the seal of this Honorable Court direct to the United States Court of Claims, commanding the court to certify and transmit to this Court for review and determination, on a date to be therein named,

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* Survey of Current Business, June, 1937, page 15, prepared in the Division of Economic Research, Bureau of Foreign and Domestic Commerce.

a full and complete transcript of the record and of the proceedings in the case numbered and entitled on its docket No. 42, Benjamin B. Foster and Robert B. Todd, Executors of the Estate of Anna Foster Ford, Deceased, *vs.* The United States, and that said judgment of said United States Court of Claims be reversed by this Honorable Court and that your petitioner have such other and further relief in the premises as to this Honorable Court may seem meet and just, and your petitioner will ever pray.

HUGH C. BICKFORD,
R. KEMP SLAUGHTER,
C. CLIFTON OWENS,
Counsel for Petitioner.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

Opinions Below.

The first opinion of the Court of Claims, reported at 17 Fed. Supp. 191, appears at pages 11 to 15 of the transcript. The supplemental opinion, reported at 18 Fed. Supp. 790, appears at pages 15 to 19 of the transcript. The judgment of the court entered December 7, 1936, appears at page 15 of the transcript. Motion for new trial, filed February 5, 1937, was denied, with supplemental opinion, April 5, 1937 (R. 19).

Jurisdiction.

The jurisdiction of this Court is invoked under Sections 180 and 240 of the Judicial Code as amended by the Act of February 13, 1925.

Facts.

On October 10, 1929, the Foster Lumber Company had capital stock outstanding of 2,000 shares having a paid-in par value of $200,000. It also had on hand accumulated surplus (in round figures) of $4,030,000, of which $330,000 had been accumulated since February 28, 1913 and $3,700,000 had accumulated prior to March 1, 1913. On October 10, 1929, the Company distributed $1,025,000 in complete cancellation of one-fourth of its capital stock, 500 shares. On its books $50,000 (the paid-in par value) was charged against capital stock account, the balance of $975,000 was charged against surplus. In the following year, on February 11, 1930, a dividend of $225,000 was declared. Between the two dividend dates further profits of $82,000

accumulated. After reporting in full this distribution, decedent filed claim for refund, claiming that the first distribution was a distribution of capital and surplus and that the portion representing surplus, $975,000 should be charged against earnings and profits in accordance with Sections 115(b) and (c) of the Revenue Act of 1928, so that the most recently accumulated earnings since 1913 ($330,000) were exhausted thereby. Under this contention only $82,000 in earnings since 1913 would be available for the second distribution in 1930 and, therefore, only 83,000/225,000ths of the second distribution would be subject to tax. The claim was denied and suit was timely brought with the court below, which held that the entire surplus distributed in the first distribution ($975,000) should be charged against earnings prior to 1913, leaving all of the earnings subsequent thereto available for the second distribution in 1930.

The Law.

Applicable provisions of the statutes are set out in the Appendix.

Specifications of Error.

Petitioner makes the following assignments of error:

1. The Court of Claims of the United States erred in holding that none of the distribution of $1,025,000 by the Foster Lumber Company on October 10, 1929, should be considered a distribution of earnings or profits within the meaning of Section 115(b) of the Revenue Act of 1928, as required by Section 115(c) of that Act.

2. The Court of Claims of the United States erred in finding and holding that the earnings and profits at October 10, 1929, accumulated since February 28, 1913, in the amount of $330,578.98 were not distributed as a part of the distribution of $1,025,000 made on that date.

3. The Court of Claims of the United States erred in failing to find and hold that only $82,758.17 of earnings and profits accumulated since February 28, 1913, were available and distributed as a part of the distribution of $225,000 on February 11, 1930.

4. The Court of Claims of the United States erred in entering judgment for the defendant.

ARGUMENT.

The plain provisions of Sections 115(b) and (c), when read together, require surplus distributed to be distinguished from capital account and, therefore, charged against earnings or profits first to the extent of the earnings accumulated since February 28, 1913.

A clear picture of the nature of the question presented may best be obtained by considering the effect upon the book accounts of the corporation of the distribution and partial liquidation on October 11, 1929. ((R. 12).

	Accounts as of Oct. 11, 1929, before distribution.	Liquidation of ¼ of capital stock.	Balance remaining after distribution.
Capital stock account	$200,000	$50,000	$150,000
Surplus account	4,030,000	975,000	3,055,000

It is obvious, in a bookkeeping sense, that the $975,000 excess over the capital paid-in was properly charged against surplus, not only because there was no place else to charge it, but because the liquidation actually represented a distribution of one-fourth of the capital paid in and one-fourth of the surplus accumulated. There was no justification for charging against the capital stock account the surplus distributed. To do so would destroy entirely the capital contribution, raising endless questions of corporate law.

Such practice of keeping the capital contributed separate from surplus accretions is customary accounting practice.*

We submit that the Revenue Act has the same concept. It uses the terms "capital account" and "earnings or profits." If part of a distribution is "capital account" it "shall not be considered * * * earnings or profits." (115(c)). There could not be a more exclusive contra-distinction. Conversely, if a part of the distribution is "earnings or profits" it cannot be chargeable to "capital account." The two portions are mutually exclusive of each other. Yet the court below holds that "earnings or profits" accumulated prior to March 1, 1913, are capital account, which is contrary to law because the statute expressly provides that such capital account shall not be considered * * * "earnings or profits", which term includes earnings both before and after 1913. In other words, "earnings or profits" cannot be "capital account."

The basic defect of the decision below is that it fails to recognize the precise distinctions made in Section 115(a) (b) and (c). As stated in the petition, the statute uses three terms; "dividends" (a); "earnings or profits"—

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* Geier & Mautner, Practical Corporation Accounting, 1930 p. 342, gives the historical development:

"From the beginning of bookkeeping, the traditional method has been to keep the capital contributions distinct from the accretions of profit. Thus the proprietor, consistent with business procedure, could draw profits from the business without encroaching upon his capital. With the development of the modern business corporation other elements entered into the situation. What had been a rational bookkeeping arrangement for segregating classes of information for the guidance of the proprietor became a procedure essential to compliance with legal limitations, such as those respecting the payment of dividends."

"The legal restrictions impressed by statutory provisions regulating par value shares upon the dealings with capital contributions of stockholders have emphasized the necessity of very careful accounting methods in order to avoid unwitting legal violations. The importance of establishing correct accounting procedures to provide that the capital fund shall not be impaired has inevitably influenced the corporation accountant's conception of capital as something that must be isolated from its accretions."

(a), (b) and (c); and "capital account"—(c). In (a) the "dividends" are limited to that *part* of "earnings or profits" earned *after* 1913. In (b) it is made clear that the term "earnings or profits" includes earnings both before and after, and is, therefore, synonymous with the corporate terms "surplus" or "undivided profits." This is clear from the Senate Finance Report explaining the revision of 201(b) in the 1924 Act when 115(c) was changed to its present reading:

> "Section 201(b): (1) The first sentence of section 201(b) of the existing law provides that any distribution made by a corporation shall be deemed to be made out of earnings and profits to the extent of the earnings and profits accumulated after February 28, 1913. It contains no similar presumption as to the source of a distribution made after all such earnings and profits have been distributed. *Since distributions out of earnings and profits accumulated prior to March* 1, 1913, *and distributions out of capital are in some instances treated differently, it is material to know the source of a given distribution, even though all earnings and profits accumulated since February* 28, 1913, *have been distributed.* Consequently, in Section 201(b) of the bill *the presumption that every distribution is out of earnings and profits applies to all earnings and profits, whether accumulated prior or subsequent to* March 1, 1913." (Italics supplied.)

Finally, subsection (c), for purposes of liquidation, distinguishes "capital account" from "earnings or profits." The distinction in (c) is not between capital ad the more restricted "dividends" of (a); it is a distinction between capital and the broader term "earnings or profits" of (b), which includes "dividends", as defined, and also earnings prior to March 1, 1913. The court below constantly holds that this distribution is not a "dividend" when that is not the question because subsection (c) does

not refer to "dividends" or to subsection (a) (R. 13, 17). The question distinctly is: what *part* of the distribution is "capital account" and what other part is "earnings or profits," under subsection (b). A recognition of this distinction in the plain words of the statute makes it manifest that $50,000 of the distribution was the part chargeable to capital account and that $975,000 was the part to be considered "earnings or profits within the meaning of subdivision (b)." Being earnings and profits within (b) the part totaling $975,000 must be charged against earnings subsequent to 1913 to the extent thereof according to the plain words of (b). *John B. Stewart,* 29 B. T. A. 809; *Horrmann* v. *Commissioner,* 34 B. T. A. 1178; *Craig, Executor,* v. *Commissioner,* Memorandum Opinion, not reported, but see Appendix B; *Harter* v. *Helvering,* 79 F. (2d) 12 (C. C. A. 2); *Glenmore Securities Co* v. *Commissioner,* 62 F. (2d) 780, (C. C. A. 2).

Consideration of the Opinions Below.

The court below first rendered opinion without reference to any decided cases (R. 11-15). The substance of the opinion is contained in several sentences which we shall consider in order.

The court first states (R. 13):

> "Clearly the distribution was not a dividend, either in the special sense that the word is used in the statute as defined in section 115(a), or in its meaning as generally used, which is somewhat broader. The definition set out in the statute was evidently inserted to make sure that there could be no claim that a distribution made out of profits was not a dividend. The distinction between a dividend and such a distribution as is made in the case before us is quite plain."

As heretofore pointed out, we are not concerned with "dividends" under subdivision (a) because the controlling

subdivision (c) does not refer to (a) but to "earnings and profits" under (b).

The court further adds (R. 13):

> "When the stockholders obtained the March 1, 1913 value of their stock, it was the realization of capital, and was properly chargeable to capital account."

This is entirely foreign to the question at issue. What was properly chargeable to capital account has reference only to the books of the corporation and not to any accounts that may be conceived as having been kept by the individual stockholders. It is not sufficient to say they received "capital". The corporation distributed capital paid in and also earnings and profits. *Helvering* v. *Canfield, supra.*

The court below then states (R. 14):

> "A consideration of the purpose of section 115(c) of the Act of 1928 and the reports made by the committees of the House and Senate when it first became a part of the revenue law supports the view above expressed. As the law originally stood, the plan devised in the case before us could be carried out so that the earnings and profits accumulated since 1913 would be distributed tax free. The general provisions of 115(b), which were in the former act, would have required the distribution to be treated as made out of earnings or profits accumulated after February 28, 1913, and the distribution would be properly chargeable to surplus and paid out of such profits with the result that the distribution made October 10, 1929, absorbed all of the earnings and profits to that date. Obviously this would enable the stockholders to escape taxation although they had received earnings and profits which had accumulated since February 28, 1913."

This misconstrues the Acts prior to the adoption of 115(c). Prior to that time (except under the 1918 Act),

a liquidation was not tax free but was taxed to the stockholders as a "dividend" to the extent of earnings after March 1, 1913. This was found to be almost impossible of administration because thousands of stockholders did not have the figures to compute such portion of their scattered dividends. Congress, therefore, added 115(c) so as to tax such distributions, in the hands of the individuals, as a gain on sale, which permitted a stockholder to compare his own cost with what he received, a much simpler administrative method. Whether tax was paid in either event depended solely on individual circumstances. As the Senate Finance Committee said in reporting Section 201(c) of the Revenue Act of 1924:

> "Treating such a transaction as a sale and within the capital gain provisions is consistent with the entire theory of the Act and, furthermore, is the only method of treating such distributions which can be easily administered." (Report No. 398, supra. p. 12.)

This applies, of course, only to the first sentence of 201(c) (as does the portion of the Committee Report cited by the court below) and deals with the manner of taxing the gain in the hands of the individual. It has nothing to do with the effect on the earnings and profits in the hands of the corporation provided for in the last sentence of subsection (c) which, as heretofore explained, expressly provides for part to be considered capital account and part to be earnings under subdivision (b).

The court below further says (R. 14):

> "Money paid out in making a return of capital is 'properly chargeable to capital account.'. It is true that the reports presented the matter 'from the point of view of the stockholder' but the principle is the same when applied to the corporation."

How can a corporation with thousands of stockholders who bought their stock at different dates and at different

prices know when it makes a distribution in partial liquidation what was "the capital account" of each individual stockholder? What may be capital account from the point of view of the stockholder (his individual cost) is manifestly quite a different thing from what is the capital account of the corporation making the distribution.

The court below again says (R. 15):

> "If the distribution of 1929 was charged to capital account as it should be according to what we have held above, the profits which had accrued since 1913 and then on hand would not be depleted thereby."

What the court below fails to recognize is that in holding that the distribution was not to be charged to earnings after 1913, it necessarily held that all of the surplus distributed *was* charged to the earnings *prior* to 1913. In other words, it holds that this is the part chargeable to capital account (which "shall not" be considered earnings or profits), and then *actually charges it against earnings and profits prior to 1913,* which is directly contrary to the Section 115(c) which says the part thus chargeable "shall not be considered a distribution of earnings or profits." The whole gist of the matter, under the section quoted, is that *if* the surplus *is* earnings and profits it cannot be chargeable to capital account. It is only by giving the term "capital account" this definition that the statute has logical meaning.

The supplemental opinion (R. 15-19) was rendered after motion for new trial was filed pointing out that the court had considered none of the authorities cited. First, such supplemental opinion seeks to distinguish *Helvering* v. *Canfield, supra,* with the statement that the 1921 Act was different from the 1928 Act. It is true that the 1921 Act taxed a liquidation as a dividend in the hands of the stockholder, while the later act taxes it as a sale. However, that change in the taxable status in the hands of the *individual*

can have no effect on the corporate accounts. As the Senate Finance Committee pointed out, the last sentence, which provided for the effect on the corporation, "represents what is probably the correct construction of the existing law and unquestionably what is in accord with business practice." (*Infra.* Cit.) Congress, therefore, intended no change in the priority of the distribution of accumulated profits, but only in the manner of taxing the distribution in the hands of the individual. So far as this case is concerned, which involves only the last sentence of Section 115(c), and not the first part—the 1928 Act had the same meaning as the 1921 Act and *Helvering* v. *Canfield, supra,* is equally applicable.

The court below then says that in *Stewart* v. *Commissioner,* 29 B. T. A. 809, the Board held that the distribution was not a distribution in partial liquidation (R. 17). The Court is apparently confused by the complexity of the issues in the *Stewart* case, as a careful reading thereof will show. When that case came before the Board there was exactly the situation we have here; a first distribution, which both parties admitted was in partial liquidation, then a second distribution which was admitted to be a regular dividend. The question was exactly the same as here; whether the first liquidating distribution exhausted the earnings after 1913. The Commissioner then raised another affirmative issue to the effect that the *second* distribution was *also* in partial liquidation. The Board held that he had not proved this and refused to hold the *second* distribution to be in liquidation. That disposed of the affirmative issue and the Board then proceeded to decide the case on the remaining original issue, which was exactly similar to the facts here (see page 813; B. T. A. Vol. 29). The court below admits disagreement with *Horrmann* v. *Commissioner,* 34 B. T. A. 1178 (R. 17-18).

As to *Harter* v. *Helvering,* 79 F. (2d) 12, the court holds that that case did not involve a partial liquidation. It is

true that the Second Circuit did not expressly refer to 115(c), but a liquidation was inherent in the case as shown by the Board's decision, *30 B. T. A. 572.* The facts there were also complicated by the existence of several subsidiary corporations, which transferred their capital and surplus between each other until it finally was distributed to the ultimate stockholders. The Court carefully eliminated each of these subsidiary transactions under the reorganization sections, holding that the capital and surplus of each carried through, *in status quo,* to the ultimate transaction. Then the ultimate transaction was this: The final corporation first retired its preferred stock, then paid a dividend, and the question was the effect upon earnings and profits of the first, a liquidating distribution. The same ultimate facts exist here. The Second Circuit held that the distribution "must be marshalled first against the earnings after February 8, 1913, for it more than exhausted them. What was left was capital *or* earlier earnings." It will be noted in the italicized word that the Second Circuit did not miss the precise distinction between "capital" and "earnings prior to March 1, 1913," and accordingly reached the proper conclusion.

The court below then refers to *Hellmich* v. *Hellman,* 276 U. S. 233, and quotes a part of that decision which seems to indicate that all earnings distributed in a liquidation are capital. This Court, in *Hellmich* v. *Hellman,* was considering the manner of taxing a distribution in the hands of the distributee. It was not concerned with the source of the distribution, as we are here. In fact, this Court, in *Hellmich* v. *Hellman,* expressly recognized that the liquidation distribution, although taxable as a sale in the hands of the distributee, was actually out of earnings and profits. The Court said (276 U. S. 236):

> "The controlling question is whether the amounts distributed to the stockholders *out of the earnings and*

> *profits accumulated by the corporation since February* 28, 1913, were to be treated as 'dividends' which were exempt from the normal tax; or, under 201 (c) as payments made by the corporation in exchange for its stock, which were taxable as other gains or profits."

Here, there is no question how the two dividends should be taxed in the hands of the stockholders. The first is admitted by both sides to be taxable as a capital gain, the second as an ordinary dividend. The limited question is the source from which the first dividend was paid, which, to the extent of the surplus was manifestly from "earnings or profits within the meaning of subdivision (b)."

The opinion of *Hellmich* v. *Hellman,* also holds that an entire section should be read so as to bring two subdivisions into harmony and to give to each its natural and due effect is important here. As previously pointed out, Section 115(c) prohibits the charging of that part representing "capital account" against "earnings or profits". The court below nevertheless holds the entire distribution to be "chargeable to capital account" and then proceeds *to charge it against earnings or profits prior to March 1, 1913,* which destroys the whole meaning of the section, and eliminates that part of the subdivision which clearly requires that some part of the distribution shall be considered "within the meaning of subdivision (b)". It is only by considering the capital paid in as the "part properly chargeable to capital account" that the section acquires a logical meaning. Then the paid in capital is charged to capital account and earnings and profits are charged within the meaning of subdivision (b).

The court below then finally directly disagrees with the decision of the Board in *Craig, Executor,* v. *Commissioner* (see Appendix B), in which the Board held as we contend in the case of another stockholder of the same corporation,

who received exactly the same distributions of the Foster Lumber Company as here involved.

The decision of the court below is, therefore, contrary to every other decided case.

Conclusion.

It is respectfully submitted, therefore, that the decision of the Court of Claims below was in error and that the conflicting decisions of the Board of Tax Appeals and the Circuit Court of Appeals for the Second Circuit correctly express the law under Section 115(c) of the Revenue Act. The Court of Claims should, therefore, be reversed and it is accordingly submitted that petition for certiorari should be granted.

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Washington, D. C.,
Attorney for Petitioner.

Of Counsel:
R. KEMP SLAUGHTER.
C. CLIFTON OWENS.

APPENDIX A.

Revenue Act of 1928.

SEC. 115. *Distributions by Corporations.*

(a) Definition of dividend.—The term "dividend" when used in this title, (except in section 203 (a)(4) and section 208 (c)(1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.

(b) Source of distributions.—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the basis of the stock provided in section 113.

(c) Distributions in liquidation.—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. In the case of amounts distributed in partial liquidation (other than a distribution within the provisions of section 112(h) of stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of subsection (b) of this section for the purpose of determining the taxability of subsequent distributions by the corporation.

(d) Other distributions from capital.—If any distribution (not in partial or complete liquidation) made by a corpora-

tion to its shareholders is not out of increase in value of property accrued before March 1, 1913, and is not out of earnings or profits, then the amount of such distribution shall be applied against and reduce the basis of the stock provided in section 113, and if in excess of such basis, such excess shall be taxable in the same manner as a gain from the sale or exchange of property. The provisions of this subsection shall also apply to distributions from depletion reserves based on the discovery value of mines.

(h) Definition of partial liquidation.—As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

APPENDIX B.

UNITED STATES BOARD OF TAX APPEALS.

Docket No. 74679.

W. H. CRAIG, Executor, Estate of Mary Foster Craig, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

E. C. Boye, C. P. A. and Carl D. Matz, Esq., for the petitioner. Carroll Walker, Esq., for the respondent.

MEMORANDUM OPINION.

ARNOLD:

The respondent determined a deficiency against Mary Foster Craig for the year 1930 in the amount of $363.93. The petitioner brings this proceeding for the redetermination of her tax liability. It is alleged that the respondent erred in including in taxable income for the year 1930, the full amount of a dividend of $21,750 received by Mary Foster Craig from the Foster Lumber Company in 1930.

Mary Foster Craig, deceased October 17, 1933, was during the entire calendar year 1930 and until her death a married citizen of the United States of America with residence at 828 West 56th Street, Kansas City, Missouri.

Mary Foster Craig, before March 15, 1931, filed with the Collector of Internal Revenue at Kansas City, Missouri, her separate individual income tax return for the calendar year 1930. She reported therein a net taxable income of $24,597.56, as having been received by her during that calendar year and a tax liability thereon of $481.83, which entire amount she paid to the Collector of Internal Revenue at the time of filing her said income tax return on February 16, 1931.

On November 17, 1933, the Commissioner of Internal Revenue pursuant to section 272 of the Revenue Act of 1928, addressed a letter to the said Mary Foster Craig advising her of a deficiency in her income tax liability of $363.93, for the calendar year 1930, resulting from a net taxable income of $29,292.94, as redetermined by the Commissioner instead of $24,597.56 as reported in her return.

Mary Foster Craig was, on February 11, 1930, the owner of record of 145 shares of a par value of $100 per share of the total of 1,500 shares of the capital stock of the Foster Lumber Company, a Missouri Corporation. She acquired this stock prior to March 1, 1913. The Foster Lumber Company on February 11, 1930, duly made a dividend distribution in cash of 150 per cent of its capital stock payable pro rata on that date to all stockholders of record on that date. Mary Foster Craig received during the calendar year 1930 the amount of $21,750 from the Foster Lumber Company as her part of the aforementioned distribution on the 145 shares of stock owned by her. The entire amount of the said distribution of $21,750 received by her during 1930 has been included in the net taxable income on which the deficiency in tax is predicated as an ordinary dividend.

On or about August 2, 1932, the said Mary Foster Craig filed with the Collector of Internal Revenue at Kansas City, Missouri, a claim for refund in the amount of $473.88 for overpayment of income taxes for the calendar year 1930. The said claim was predicated on the basis that, of the dis-

tribution of $21,750 received by her from the Foster Lumber Company during 1930 and reported in its entirety, the amount of $13,802.33 was paid out of surplus accumulated or appreciation of land and timber arising before March 1, 1913, and was to that extent and for that reason exempt from tax. The Commissioner of Internal Revenue disallowed the contention raised in the claim and instead determined the deficiency of $363.93 by disallowing a loss claimed on the return of $4,695.38.

The sole question to be determined in this proceeding, is the extent to which the distribution received in 1930 is taxable.

The Foster Lumber Company was organized under the laws of the State of Missouri during 1896 and was at all times herein mentioned and now is a Missouri corporation. At all times subsequent to its organization and prior to October 10, 1929, said company was authorized to issue and had issued as its only capital stock 2,000 shares of common stock having a par value of $100 per share.

The purposes for which the Foster Lumber Company was formed are the manufacturing, buying and selling of lumber, buying and selling of grain, coal, glass, paints, oils, lime, hair, brick and all other kinds of building material, whether they be of the same class or kind of any of those above, especially mentioned or described or not; the buying and selling of general merchandise, and the buying, selling, and leasing of lands, when the same may be necessary in the conduct of its said business.

On March 1, 1913, the earnings or profits accumulated and increase in value of property accrued prior to that date of the Foster Lumber Company were in excess of $3,725,000.

The following tabulation sets forth with reference to the Foster Lumber Company, in column "A" the period involved, in column "B" the amount of the earnings, or profits for that period, in column "C" the amount of distribution on the last day of the indicated period and in column "D" the balance of the earnings, or profits accumulated subsequent to February 28, 1913:

(Tabulation not quoted.)

The capital stock of the Foster Lumber Company has always been owned by members of the Foster family. Three members of the family who had removed to California were stockholders in the corporation and in order that they might retire from ownership of and participation in the affairs of the corporation and also that a rearrangement of interests might be effected it was decided to retire and cancel 500 shares of the company's capital stock. Accordingly, under date of July 20, 1929, the Foster Lumber Company by formal written notice to all of its stockholders requested that each of them notify it if they were in favor of a reduction in the capital stock of the company from $200,000 to $150,000 by the acquisition and cancellation by the company of $500 shares of its outstanding capital stock of 2,000 shares from the therein named stockholders in the proportions and for the amounts set forth in that letter.

Under date of September 18, 1929, the Foster Lumber Company by formal written notice to all of its stockholders advised them that since they had indicated their desire to decrease the capital stock of the company from $200,000 to $150,000, as per letter of July 20, 1929, it was necessary, under the statutes of the State of Missouri, to hold a special meeting of the company's stockholders, at which all of the said stock must be represented either in person or by proxy, and to pass a unanimous resolution for the decrease in capital stock as set forth in its notice to stockholders dated July 20, 1929. They and each of them were also requested to execute a waiver of publication and mailing of notice and consent to the said reduction in the capital stock at said special meeting of stockholders.

Each and everyone of the stockholders executed a waiver of publication and mailing of notice and consent to the reduction in capital stock as requested by the Foster Lumber Company and mailed the same to the said corporation.

At a special meeting of the stockholders of the Foster Lumber Company held October 1, 1929, at the office of that company at which all of the stockholders of said company were present in person, or were represented by proxy, the

following resolution was adopted by the unanimous vote of all the stockholders:

Upon motion, duly made and seconded, it was resolved that:

WHEREAS, the capital stock of the company is for the sum of Two Hundred Thousand Dollars, divided into two thousand shares, of the par value of One Hundred Dollars each, and,

WHEREAS, the Company has no outstanding unpaid obligations except the comparatively small amount of current accounts payable, and

WHEREAS, there are ample funds in the treasury of the Company to do so:

BE IT RESOLVED: That the capital stock of the Company be decreased from said Two Hundred Thousand Dollars, divided into Two Thousand Shares of the par value of One Hundred Dollars, to the sum of One Hundred and Fifty Thousand Dollars, divided into Fifteen Hundred shares of the par value of One Hundred Dollars each.

The Foster Lumber Company having theretofore in all respects complied with the laws of the State of Missouri made and provided for the decrease of capital stock, the Secretary of State for the State of Missouri on October 8, 1929, certified to the decrease in the capital stock of that corporation to the amount of $150,000.

On October 10, 1929, the Foster Lumber Company distributed $1,025,000 in cash to its stockholders for 500 shares of its capital stock retired on that date pursuant to the resolutions adopted at the special meeting of its stockholders held October 1, 1929, and as set out above. On the books of the corporation, $975,000 of the amount distributed was charged to surplus and $50,000 to the capital stock account. The stock retired was immediately cancelled.

The distribution of October 10, 1929, was on the basis of $2,050 per share. For the purpose of determining the taxable income for 1929, all the stockholders whose stock was retired, contended for a March 1, 1913, value of $2,090.75 per share, or a loss of $40.75 per share. The tax liability was finally settled by agreement with the several

stockholders upon a valuation at March 1, 1913, of $2,050 per share. There was no taxable income to the stockholders determined as arising out of the retirement of the stock in 1929.

The authorized and issued capital stock of the Foster Lumber Company from and after the distribution of October 10, 1929, continuously to the present time has been in the amount of $150,000 represented by 1,500 shares of a par value of $100 per share.

The applicable statute and the regulations promulgated thereunder are set out in the margin. As we read the statute, the distribution of October 10, 1929 must be marshalled first against the capital to the extent of the par value of the 500 shares of stock redeemed and retired, then against the earnings after February 28, 1913 which were on hand October 10, 1929. It more than exhausted these sources and what was left was paid from capital or earnings accumulated prior to March 1, 1913. It follows therefore that the dividend distribution of February 11, 1930, in the amount of $225,000 should be marshalled first against the earnings or profits accumulated subsequent to October 10, 1929 and on hand February 11, 1930 ($82,758.17) and then against the capital increment or earnings or profits accumulated prior to March 1, 1913 ($142,241.83). The former is subject to a surtax in the hands of the stockholder distributee. The latter is exempt.

Petitioner's decedent received from the dividend of February 11, 1930, $21,750. Of this amount 82,758.17/225,000 is subject to surtax and the balance is exempt. *John E. Stewart et al.*, 29 B. T. A. 809; *Harter* v. *Helvering*, 79 Fed. (2) 12.

Since petitioner's decedent included the entire dividend of $21,750 in her return and there will result an overpayment of her tax.

The decision will be entered under Rule 50.

Entered: Mar. 15, 1937.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1937

No. 189

BENJAMIN B. FOSTER AND ROBERT R. TODD, EXECUTORS OF THE ESTATE OF ANNA FOSTER FORD, DECEASED,
Petitioners,

vs.

THE UNITED STATES.

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS.

REPLY BRIEF FOR THE PETITIONER.

R. KEMP SLAUGHTER.
HUGH C. BICKFORD.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1937

No. 189

BENJAMIN B. FOSTER AND ROBERT R. TODD, EXECUTORS OF THE ESTATE OF ANNA FOSTER FORD, DECEASED,
Petitioners,

vs.

THE UNITED STATES.

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS.

REPLY BRIEF FOR THE PETITIONER.

The brief of respondent does not base its argument upon the statute nor upon the decided cases, none of which are discussed, or even cited, and all of which are contrary to the decision of the court below. What respondent attempts to do is draw an inference, not from the statute, but from the words of the House Committee referring to another proposition. On this basis counsel contends that the whole of a liquidating dividend must be charged against capital account and, as a necessary corollary, that none of it be charged against earnings and profits. This conclusion is contrary to what the Congressional Committees said, is

impossible under the plain words of the statute, and is not, really, what the court below decided.

As to the Committee report quoted by respondent on pages 6 and 7, it will clearly be seen that the Committee in the portion of its report quoted was referring not to the last sentence of Section 115 (c), with which we are concerned, but was referring to the first and second sentences of that subdivision which provided that amounts received by the stockholder "shall be treated as in part or full payment in exchange for the stock. The gain or loss *to the distributee* resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112." In other words, the stockholder should treat the profit or loss as one from a sale of goods and not as a dividend subject only to surtaxes. Dealing with this proposition the House Committee said that "from the viewpoint of the stockholder" it is to be treated as a return of his capital. Thus used, the quoted phrase "from the viewpoint of the stockholder" is really one of limitation which limits the effect of the part of the section there discussed only to the stockholder. If Congress has intended to say that the corporate accounts should also treat the whole distribution as a charge against the paid-in capital account it would have said so; it would not have carefully limited the application only to the stockholder. But, as pointed out, the Committee was there referring only to the *manner* of taxing the receipt in the hands of the stockholder. When it discussed the effect of the distribution upon the capital and earnings of the distributor, the corporation,—in the very same report—the Committee said:

> "Since distributions out of *earnings* * * * and distributions out of *capital* are in some instances treated differently it is material to know the source of a given distribution, even though all earnings and profits accumulated since February 28, 1913, have been

distributed. Consequently, in section 201 (b) the presumption that *every* distribution is out of earnings and profits applies to *all earnings and profits, whether accumulated prior or subsequent to March 1, 1913.*" (Senate Report No. 398, 68th Cong., 1st Sess., p. 11.) (Italics added.)

Thus, when the Committee talks about the point involved in this case (the effect upon the corporate accounts) the Committee expressly draws the exact distinction between "capital" and "all earnings and profits, whether accumulated prior or subsequent to March 1, 1913."

As to the statute, the respondent's position that none of the liquidating distribution was a distribution out of earnings or profits (p. 9) is clearly untenable. Repeating what was said in the original brief, Section 115 (c) states that the "part" which is charged to capital account "*shall not*" be considered "earnings or profits" under subdivision (b). Subdivision (b) defines earnings and profits as including earnings both before and after March 1, 1913. If the capital account included all of the liquidating dividend, as counsel contends, then to charge *any* of it against earnings "whether accumulated prior or subsequent to February 28, 1913," would be directly contrary to the words of the statute. Yet counsel asks that this be done when he contends that the surplus distributed be charged against earnings prior to March 1, 1913. As said in the original brief, it is only by construing the term "capital account" as synonomous with "paid-in capital", according to recognized accounting practice, that the section can be sensibly and logically applied. The balance of the distribution would then be charged against earnings and profits "within the meaning of subsection (b)". The "meaning of subsection (b)" requires the charge to be made against the most recently accumulated earnings until exhausted and then against the "earnings or profits" prior to March 1, 1913.

A further point to consider in determining whether Congress referred to the stockholder or to the corporation when it said "the amount chargeable to capital account" is to consider the use of the word "*chargeable*". In accounting parlance, as well as in the ordinary usage of language, a "charge", or something that is "chargeable", is an item of outgo or expense, something paid out or charged against assets. Income or receipt is always referred to as a "credit" and is "credited." Only the corporation would consider money *paid out* in retirement of stock, as a charge or chargeable to its capital account. The stockholder would naturally consider the receipt of such money as a credit and would "credit" it to his capital account, not charge it thereto. Accordingly, when Congress uses the term "chargeable", it necessarily referred to the treatment on the books of the payor, the corporation.

The Court below similarly holds that the whole distribution is "capital" and, therefore, that none of it should be charged to "earnings or profits". But the Court then proceeds to charge it against earnings prior to 1913, precisely what the statute prohibits.

On page 10 of his brief the Respondent concludes with the statement that the question is unimportant, immediately after having said that he disagrees with the Board's contrary decision in the *Craig* case and will take an appeal therein.* The *Craig* case involves only $363, much less than it will cost the respondent to prosecute his appeal. Apparently, in that case, the respondent considers the *Craig* case of great importance and is going to prosecute an appeal at a cost of much more than the amount involved to obtain what he conceives to be the proper decision, but here, he informs the Court the question "is of no general public interest or importance".

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* The appeal has now been taken.

It is apparent that the recent enactment of the Undistributed Profits Tax on Corporations, allowing deduction for dividends paid, causes the dividend question to be of even greater importance than in the past. There can be no doubt that conflict exists between the decision below and the decisions of other courts. We respectfully request that the petition be granted.

HUGH C. BICKFORD.
R. KEMP SLAUGHTER.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1937

No. 189

BENJAMIN B. FOSTER AND ROBERT R. TODD, Executors of the Estate of Anna Foster Ford, Deceased,
Petitioners,

vs.

THE UNITED STATES.

REPLY BRIEF FOR THE PETITIONERS.

R. Kemp Slaughter.
Hugh C. Bickford.
C. Clifton Owens.
Counsel for Petitioners.

INDEX.

Subject Index.

	Page
Reply brief for petitioners	1
Opinions below	1
Jurisdiction	1
Question presented	2
Statute and regulations involved	2
Statement	2
Argument	3
Conclusion	7
Appendix	8

Table of Cases Cited.

Harter v. *Helvering*, 79 F. (2d) 12	5
Helvering v. *Canfield*, 291 U. S. 163	4, 6
Helvering v. *Craig, etc.*, Appendix B of petition	7

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1937

No. 189

BENJAMIN B. FOSTER AND ROBERT R. TODD, EXECUTORS OF THE ESTATE OF ANNA FOSTER FORD, DECEASED,
Petitioners,

vs.

THE UNITED STATES.

REPLY BRIEF FOR THE PETITIONERS.

Opinions Below.

The original opinion of the court below (R. 7-15) is reported in 17 F. Supp. 191. Its supplemental opinion on petitioners' motion for a new trial (R. 15-19) is reported in 18 F. Supp. 790.

Jurisdiction.

The original judgment of the court below was entered December 7, 1936 (R. 15). The order overruling petitioners' motion for a new trial was entered April 5, 1937 (R. 19). The petition for a writ of certiorari was filed July 2, 1937 (R. 19), and granted on October 11, 1937 (R. 20). The jurisdiction of this Court is invoked under Section 3(b) of the Act of February 13, 1925.

Question Presented.

Whether a dividend in 1930 was paid from earnings or profits accumulated after February 28, 1913. This depends upon the effect of a distribution in 1929 in redemption of one-fourth of the corporation's capital stock at a time when there were on hand earnings or profits accumulated both before and after March 1st, 1913. If such distribution (after being charged against paid-in capital behind the shares redeemed) was chargeable against earnings after 1913 before being applied to earnings accumulated prior thereto, such subsequent earnings were exhausted and not available for the 1930 dividend which would then be a distribution from tax exempt prior earnings.

Statute and Regulations Involved.

The pertinent statutory provisions and Treasury Regulations are set forth in the Appendix, *infra*, pp. —.

Statement.

The decedent, who brought suit in the Court of Claims to recover income taxes paid on her return for 1930, died during this litigation and the executors of her estate, the petitioners herein, were substituted as parties (R. 7). The special findings of fact (R. 7 to 11) may be summarized as follows:

On December 10, 1929 the Foster Lumber Company, of which decedent was a stockholder, distributed to its shareholders $1,025,000.00 in redemption of one-fourth of its capital stock, thus reducing the total outstanding stock from 2,000 shares to 1,500 shares. Such reduction was reflected on the books of account as follows (R. 12):

Accounts.	Accounts as of Oct. 11, 1929, before distribution.	Liquidation of ¼ of capital stock.	Balance remaining after distribution.
Capital stock account	$200,000	$50,000	$150,000
Surplus account	4,030,000	975,000	3,055,000

At the time of such distribution the surplus account of $4,030,000 was composed of earnings and profits accumulated after March 1, 1913 in the amount of $330,578.98, the remainder of more than $3,000,000 representing profits accumulated prior to 1913. The court below held that the distribution of $975,000 in surplus should be applied against the earnings accumulated prior to March 1, 1913 and that none of such distribution should be charged against most recently accumulated earnings since 1913. The petitioners contend that the distribution of surplus should have been first applied to the extent of the most recently accumulated earnings of $330,578.98 which would have exhausted such earnings entirely. In that event the earnings available for the subsequent dividend distribution on February 11, 1930 would be only the amount accumulated between October 10, 1929 and February 11, 1930, the sum of $82,758.17.

Argument.

The petitioners having set forth their argument in the petition for certiorari and brief in support thereof, desire at this time to answer briefly the arguments presented in the brief of the United States filed on the merits. This will be done in numbers corresponding to the paragraphs in respondent's argument.

1. *Preliminary.*—This portion of the Government's brief merely sets forth the statute and then argues that Section 115(b) was not intended to deplete earnings since 1913 "by a non-taxable capital exchange upon partial liquidation." At the outset this argument misinterprets the nature of a liquidating distribution under the tax acts. In the first place, a distribution in liquidation is not a non-taxable exchange. It is a distribution of capital paid-in *and* surplus standing behind the stock. In this case, $2,000 per share was distributed in the retirement, consisting of

$100 in paid-in capital and $1900 in earnings and profits. Congress, if it so desired, could have taxed the entire $1900 as a dividend. *Helvering* v. *Canfield*, 291 U. S. 163. On the other hand, Congress could treat such a retirement as an exchange between the corporation and its stockholders and tax to the stockholders only the difference between the amount received and what the particular stockholder had paid for his stock. This is what Congress did in Section 115(c) of the Revenue Act of 1928, but that choice by Congress of the manner of taxing the stockholder does not convert the earnings distributed into "capital" nor is it correct to say that the exchange is non-taxable any more than it is correct to say that a sale of property for cash is a non-taxable transaction simply because the taxability the cost in a particular case is in excess of the cash received.

2. Beginning on page 9 of its brief the United States argues that Congress intended to tax stockholders whenever there were corporate earnings that could have supported a distribution. But it taxes them according to its own rule and subject to its own exemptions. Congress has defined, under Section 115(a), a dividend as a "distribution" consisting only of earnings after 1913 then exempts even such dividends from normal tax, subjecting them only to surtaxes. Sub-division (b) provides that "every distribution" is made out of earnings or profits and from the most recently accumulated earnings or profits. It then provides that earnings or profits accumulated before 1913 may be distributed exempt from tax "*after* the earnings and profits accumulated after February 28, 1913 have been distributed." Coming to Section 115(c) Congress continues to use the word "distribution", so that, unless we are to say that the word "distribution" in sub-division (c) has a different meaning from the same word used in (a) and (b),

the rule of distributing the earnings since 1913 before any distribution is made of prior earnings must apply to all three sections.

We can see no similarity in the present case with cases involving the reorganization of corporations under Section 112 or the stock dividend cases referred to by the United States on pages 10 and 11 of the respondent's brief. It is clear that a reorganization under Section 112 is simply a maintenance of the *status quo* and, in tax effect, carries through the capital stock account and the earnings and profits to the corporation finally resulting. (See *Harter* v. *Helvering*, 79 F. (2d) 12.)

Counsel then argues, on page 14 of his brief, that Section 115(b) is only applicable to taxable dividends. What counsel really claims here is that sub-division (b) has no reference to anything except sub-division (a) which defines taxable dividends as being earnings accumulated after March 1, 1913. This meaning is impossible of acceptance, we submit, because sub-division (b) itself refers to earnings and profits *both* before and after 1913. Furthermore, as pointed out in the brief in support of the petition for certiorari (page 15), it was stated by the Senate Finance Report when Section 115(b) was changed to its present reading as Section 201(b) of the Revenue Act of 1924:

> "Since distributions out of earnings and profits accumulated prior to March 1, 1913 *and* distributions out of capital are in some instances treated differently, it is material to know the source of a given distribution even though all earnings and profits accumulated since February 28, 1913 have been distributed. Consequently, in Section 201(b) of the Bill the presumption that every distribution is out of earnings and profits, applies to *all* earnings and profits whether accumulated prior or subsequent to March 1, 1913." (Senate Report No. 398, 68th Congress, 1st Session, p. 11.)

It would be difficult to find clearer language which directly answers the whole contention of the United States that Section 115(b) has no application to sub-section 115(c) but only applies to 115(a). The Senate amended Section 115(b) in 1924 as above stated to make sure that it applied to "every distribution" whether such distribution accumulated prior or subsequent to March 1, 1913. In so doing it made the same distinction between "capital" and *all* earnings for which we contend.

3. Under this heading the United States suggests an alternative treatment of regarding each share of stock as having behind it a proportional part of the various accounts of the corporation and, accordingly, that the distribution could be considered as changed proportionately against the earnings prior to 1913 and subsequent to 1913. Such a proposal may well have merit as a matter of general logic but it is not the method adopted by Section 115 of the Revenue Act. Section 115(c) provides that the capital account shall be so charged, but that the remainder shall be considered a distribution of earnings or profits within the meaning of subsection (b) which expressly provides, as to "every distribution", that the earnings after 1913 shall be distributed first.

4. Under this Section, beginning on page 18 of the respondent's brief, it is contended that the words "capital account" include earnings and profits earned prior to March 1, 1913. We believe this has been adequately answered in the brief in support of petition for the writ, for, as stated in *Helvering* v. *Canfield,* 291 U. S. 163, such prior earnings are not capital even in the broad constitutional sense, but are earnings or profits expressly exempted by Section 115(b) of the Act. In fact, the Act itself, in Section 115(b), in providing for the exemption from taxation, refers to such prior earnings as "any earnings or profits

accumulated • • • before March 1, 1913." Surely, when Congress itself, in the very section under question, referred to such prior earnings as "earnings or profits" it cannot be said that Congress intended them to be capital even in the loose sense which counsel suggests.

Conclusion.

Section 115 of the pertinent Revenue Act provides for

1. A distribution of earnings or profits most recently accumulated. This is a taxable distribution of the earnings or profits accumulated subsequent to February 28, 1913.
2. A distribution of earnings or profits accumulated before March 1, 1913. This is a non-taxable distribution.
3. A distribution in complete or in partial liquidation. This shall be treated as in part or full payment in exchange for the stock.

The essence of this appeal is that "every distribution" is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Under the plain language of the statute the intention is clear to first exhaust earnings that are taxable as dividends. Par. (c) of Section 115 makes an exception when the distribution is in partial *liquidation*. It provides that the *part of such distribution* which is *properly* chargeable to *capital account* shall not be considered a distribution of earnings or profits. The word "liquidation" contemplates and comprehends the retirement of outstanding capital stock. The words "capital account" similarly and exclusively contemplate and comprehend the outstanding capital stock on the books of the corporation. To the extent that a distribution is *properly* chargeable to this cpaital account it "shall not be considered a distribution of earnings or profits."

In the instant case, in the distribution and liquidation of October 10, 1929 (R. 12) one-fourth ($50,000.00) of the amount was *properly* charged to "capital account". This was the par value of one-fourth of the capital stock outstanding. To this extent the distribution "shall not be considered a distribution of earnings or profits." And so, the United States Board of Tax Appeals held in *Helvering* v. *Craig, etc.* (see Appendix B in the petition for certiorari) that

> "* * * the distribution of October 10, 1929 must be marshalled first against the capital to the extent of the par value of the 500 shares of stock redeemed and retired, then against the earnings after February 28, 1913 which were on hand October 10, 1929."

The judgment of the Court of Claims should be reversed.

Respectfuly submitted,

R. KEMP SLAUGHTER,
HUGH C. BICKFORD,
C. CLIFTON OWENS,
Counsel for Petitioners.

APPENDIX.

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of dividend.*—The term "dividend" when used in this title (except in section 203 (a) (4) and section 208 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.

(b) *Source of distributions.*—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the basis of the stock provided in section 113.

(c) *Distributions in liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. In the case of amounts distributed in partial liquidation (other than a distribution within the provisions of section 112 (h) of stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of subsection (b) of this section for the pur-

pose of determining the taxability of subsequent distributions by the corporation.

* * * * * * *

(h) *Definition of partial liquidation.*—As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

Treasury Regulations 74:

ART. 622. *Source of distribution.*—For the purpose of income taxation every distribution made by a corporation is made out of earnings or profits to the extent thereof and from the most recently accumulated earnings or profits.

ART. 623. *Distributions out of earnings or profits accumulated, or increase in value of property accrued, prior to March 1, 1913.*—Any distribution by a corporation out of earnings or profits accumulated prior to March 1, 1913, or out of increase in value of property accrued prior to March 1, 1913 (whether or not realized by sale or other disposition, and, if realized, whether prior to or on or after March 1, 1913), is not a dividend within the meaning of Title I. A corporation can not distribute earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, exempt from tax, unless and until all earnings or profits accumulated since February 28, 1913, have been distributed. Whenever one corporation receives from another corporation distributions out of earnings or profits accumulated by such other corporation prior to March 1, 1913, or out of increase in value of its property accrued prior to March 1, 1913, and the "receiving" corporation, after having first distributed all of its earnings and profits accumulated since February 28, 1913, distributes to its shareholders the amount so

received by it from such other corporation, the distribution by the "receiving" corporation to its shareholders is not a dividend within the meaning of Title I and is exempt from tax.

In determining whether a dividend is out of earnings or profits accumulated since February 28, 1913, or prior to March 1, 1913, due consideration must be given to the facts, and mere bookkeeping entries increasing or decreasing surplus will not be conclusive.

* * * * * * *

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute and regulations involved	2
Statement	2
Argument	5
Conclusion	10
Appendix	11

CITATIONS

Cases:	
Craig, Executor v. *Commissioner*, decided March 15, 1937	10
Crane v. *Commissioner*, 68 F. (2d) 640	9
Stearns Co., R. H., v. *United States*, 291 U. S. 54	9
Statutes:	
Revenue Act of 1924, c. 234, 43 Stat. 253, Sec. 201	6
Revenue Act of 1928, c. 852, 45 Stat. 791, Sec. 115	11
Miscellaneous:	
H. Rep. No. 179, 68th Cong., 1st Sess., pp. 11–12	6
S. Rep. No. 398, 68th Cong., 1st Sess., p. 12	6
Treasury Regulations 74:	
Art. 622	12
Art. 623	12

In the Supreme Court of the United States

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ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The original opinion of the court below (R. 7–15) is reported in 17 F. Supp. 191. Its supplemental opinion on petitioners' motion for a new trial (R. 15–19) is reported in 18 F. Supp. 790.

JURISDICTION

The judgment of the court below was entered December 7, 1936. (R. 15.) The order overruling petitioners' motion for a new trial was entered

April 5, 1937. (R. 19.) The petition for a writ of certiorari was filed July 2, 1937. (R. 19.) The jurisdiction of this Court is invoked under Section 3 (b) of the Act of February 13, 1925.

QUESTION PRESENTED

Whether a dividend in 1930 was paid from earnings accumulated between 1913 and 1929. This depends upon whether, under a proper construction of Section 115 (c) of the Revenue Act of 1928, a distribution in partial liquidation in 1929 can be considered as having exhausted such earnings.

STATUTE AND REGULATIONS INVOLVED

The pertinent portions of the applicable statute and Treasury Regulations are set forth in the Appendix, *infra*, pp. 11–13.

STATEMENT

This is a suit to recover an alleged overpayment of taxes for the year 1930. (R. 1–7.)

The special findings of fact of the Court of Claims (R. 7–11) may be summarized as follows:

Petitioners' decedent, originally the plaintiff in this case, died March 30, 1936, and petitioners, the executors of her estate, were substituted as plaintiffs. (R. 7.) For the calendar year 1930, the decedent filed her income tax return showing a net income of $29,697.29, and a tax thereon of $850.28, which was paid at the time the return was filed. (R. 7–8.)

On February 11, 1930, decedent was the owner of 155 shares, par value $100 per share, of the total capital stock of 1,500 shares of the Foster Lumber Company, a Missouri corporation. She acquired this stock prior to March 1, 1913, at a cost less than the value as of that date which it was agreed was at least $2,000 per share. On February 11, 1930, the corporation duly declared and paid a cash dividend of 150%, and decedent received as her share thereof the amount of $23,250, which was included in her income tax return for that year as income, and a tax paid thereon. (R. 8.)

On July 18, 1932, decedent filed a claim for refund in the amount of $712.01 for the year 1930, on the ground that of the cash dividend received by her in February 1930, the amount of $14,754.22 was paid out of surplus accumulated or appreciation of land and timber arising before March 1, 1913, and was to that extent and for that reason exempt from tax. This claim for refund was rejected on September 21, 1933. (R. 8.)

On March 1, 1913, the earnings or profits accumulated and the increase in value of property owned by the company were in excess of $3,725,000. (R. 8.)

Finding 6 made by the Court of Claims, at pages 8 and 9 of the Record, sets forth a tabulation of the amount of earnings and the dividends distributed during the period from February 28, 1913, to December 31, 1930. It is not believed this tabulation

need be repeated here, as the relevant amounts therein are found as separate facts by the Court of Claims as hereinafter stated. (R. 8–10.)

The dividends distributed by the corporation from 1916 to February 12, 1929, were distributed from earnings and profits accumulated subsequent to February 28, 1913. (R. 10.)

The stock of the corporation was owned by members of the Foster family, and for family reasons it was determined, in July 1929, to reduce the total capital stock from $200,000 to $150,000 by the acquisition from the stockholders and the cancellation by the company of 500 shares of the total outstanding of 2,000 shares. (R. 10.) On October 10, 1929, the corporation pursuant to a resolution, distributed to its stockholders $1,025,000 in cash for 500 shares of its capital stock, and this stock was retired and cancelled on that date. On the books of the corporation, $975,000 of the amount distributed was charged to surplus, and $50,000 to the capital stock account. This distribution was on the basis of $2,050 per share, and subsequently it was agreed between the stockholders and the Commissioner of Internal Revenue for the United States that the value of the stock on March 1, 1913, was $2,050 per share, and therefore no income taxable to the stockholders arose out of the retirement of the stock in 1929. (R. 10–11.)

The earnings and profits of the corporation on October 10, 1929, prior to the distribution of

$1,025,000 on that date, and which had been accumulated since February 28, 1913, were $330,578.98. (R. 11.) The accumulated earnings and profits of the corporation for the period from October 10, 1929, to February 11, 1930, and prior to the cash dividend of $225,000 on the latter date, were $82,758.17. (R. 11.)

On the foregoing special findings of fact, the Court of Claims decided as a conclusion of law that petitioners were not entitled to recover, and dismissed the petition. In a supplemental opinion on petitioners' motion for a new trial, the Court of Claims adhered to its prior decision and overruled the motion.

ARGUMENT

Section 115 of the Revenue Act of 1928 (Appendix, *infra*, pp. 11–12) contains the provisions relating to distributions by corporations here involved. In subdivsion (a) thereof, it is provided that the term "dividend" as used therein means any distribution made by a corporation to its shareholders out of its earnings or profits accumulated after February 28, 1913. Under subdivision (b), the presumption is set up that every distribution is made out of earnings or profits to the extent thereof and from the most recently accumulated earnings or profits, and exempts from tax any earnings or profits accumulated prior to March 1, 1913, if distributed after the earnings and profits accumu-

lated since February 28, 1913, have been distributed. Subdivision (c) contains an exception to the provisions of subdivisions (a) and (b), and therein it is provided, in respect of amounts distributed in partial liquidation, that the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of subsecton (b) for the purpose of determining the taxability of subsequent distributions by the corporation.

Subdivision (h) defines the term "amounts distributed in partial liquidation" as meaning a distribution by a corporation in complete cancellation or redemption of a part of its stock. It is not disputed here that the distribution by the Foster Lumber Company on October 10, 1929, was in partial liquidation, resulting in complete cancellation or redemption of a part of its stock.

The provisions of Section 115 (c) of the Revenue Act of 1928 first appeared in the Act of 1924, c. 234, 43 Stat. 253, as Section 201 (c). This was new legislation not contained in the 1921 Act, and both the Senate and the House Committees, in reporting the bill, which became the Act of 1924, made the following statement (S. Rep. No. 398, 68th Cong., 1st Sess., p. 12; H. Rep. No. 179, 68th Cong., 1st Sess., pp. 11–12):

> The theory of liquidating dividends is extended to distributions in partial liquidation.

> If a corporation retires a portion of its capital stock, the transaction is treated, from the point of view of the stockholder, as a sale of his stock. If the corporation distributes an amount in partial retirement of its capital stock, the amount thereof is to be considered as a return of capital; and taxable only if, as, and to the extent that, it exceeds the basis of the stock.

From the foregoing it is clear that Section 115 (c) must be considered "from the point of view of the stockholder" and not in relation to the accounting methods or practices of the corporation. For the year 1929, petitioners' decedent contended that the amount received in the distribution made on October 10, 1929, was a return of March 1, 1913, value or capital to her, and therefore was not taxable as income, and as it was agreed that the amount received was equal to the basis of the stock, it was conceded that it should not be taxed. (R. 10–11). Thus, in the instant case, we have a situation in which petitioners' decedent, in 1929, contended that the entire amount received in the 1929 distribution was properly chargeable to capital account. Considering the matter from the point of view of the stockholder, as Congress has indicated it must be, it is plain that this contention made by the decedent in 1929 was correct. The statute is directed to the determination of the income of the stockholder, and the meaning of the phrase "properly chargeable to capital ac-

count" must be sought from the use of that term in its application to the stockholder. To the stockholder the receipt of the March 1, 1913, value of the stock was the realization of capital and was properly chargeable to capital account. On this basis, Section 115 (c) sets forth the rule that amounts distributed in partial liquidation, to the extent that they are deemed to be a return of capital, shall not be considered a distribution within the meaning of subsection (b) for the purpose of determining the taxability of subsequent distributions. In other words, such a distribution in partial liquidation is not to be considered a distribution out of earnings or profits, either prior or subsequent to March 1, 1913, and, in fact, from the point of view of the stockholder is not a distribution of earnings or profits in any sense, but is merely a return of capital which is not to be, and in the instant case has not been, taxed. (R. 10–11).

The foregoing is the construction of Section 115 (c) and the exception therein contained to the provisions of subsection (b) adopted by the Court of Claims, and it is clearly correct when the purpose of the section as revealed in the reports of the committees of Congress is kept in mind. The burden of petitioners' argument is simply this: Because of the fact that the corporation, under common accounting practice, separated the distribution made in October 1929, by charging only

$50,000 thereof to capital and the balance to surplus, petitioners contend that the taxation of the cash dividend subsequently paid in 1930 constitutes a tax upon capital rather than upon income, on the ground that the distribution in October, 1929, more than exhausted the earnings and profits which had accumulated subsequent to March 1, 1913, and was made in part out of earnings accumulated prior to February 28, 1913, which were exempt from tax.

Under the provisions of Section 115 (c) (Appendix, *infra* pp. 11–12) the distribution in partial liquidation in October, 1929, was not a distribution out of earnings or profits; it was a return to the stockholders of the March 1, 1913, value of their stock or, in other words, of their capital. As stated above, this was the position taken by the decedent in respect of the year 1929, and decedent's representatives, petitioners here, should not now be heard to argue for a different position. Cf. *R. H. Stearns Co.* v. *United States,* 291 U. S. 54; *Crane* v. *Commissioner,* 68 F. (2d) 640 (C. C. A. 1st).

In the supplemental opinion rendered by the court below on motion for a new trial (R. 15–19) the principal authorities relied upon by petitioners are fully discussed and distinguished. None of these decisions relied upon by petitioners is authority for the proposition that the exception set up in Section 115 (c) (Appendix, *infra* pp. 11–12) should be disregarded under the facts in the instant case, or for the treatment of the distribution in partial

liquidation as made out of earnings or profits. As stated by the court below (R. 19), the memorandum opinion of the United States Board of Tax Appeals in the case of *Craig, Executor* v. *Commissioner,* decided March 15, 1937, did not contain the reasoning upon which the opinion was based, and insofar as that decision of the Board is contrary to the views expressed by the Court of Claims, we submit that it is incorrect and should not be followed. The Government has not acquiesced in the decision of the Board of Tax Appeals and an appeal therefrom to the Circuit Court of Appeals has been authorized and will be taken.

CONCLUSION

This case presents only an isolated question arising under special circumstances and is of no general public interest or importance. No actual conflict of decisions has been shown, and the result reached by the court below is correct. We respectfully submit that the petition should be denied.

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AUGUST 1937.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791, 822:

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of dividend.*—The term "dividend" when used in this title (except in section 203 (a) (4) and section 208 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.

(b) *Source of distributions.*—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax; after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the basis of the stock provided in section 113.

(c) *Distributions in liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112.

In the case of amounts distributed in partial liquidation (other than a distribution within the provisions of section 112 (h) of stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of subsection (b) of this section for the purpose of determining the taxability of subsequent distributions by the corporation.

* * * * *

(h) *Definition of partial liquidation.*—As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

Treasury Regulations 74:

ART. 622. *Source of distribution.*—For the purpose of income taxation every distribution made by a corporation is made out of earnings or profits to the extent thereof and from the most recently accumulated earnings or profits.

ART. 623. *Distributions out of earnings or profits accumulated, or increase in value of property accrued, prior to March 1, 1913.*—Any distribution by a corporation out of earnings or profits accumulated prior to March 1, 1913, or out of increase in value of property accrued prior to March 1, 1913 (whether or not realized by sale or other disposition, and, if realized, whether prior to or on or after March 1, 1913), is not a dividend within the meaning of Title I. A corporation can not distribute earnings or

profits accumulated or increase in value of property accrued prior to March 1, 1913, exempt from tax, unless and until all earnings or profits accumulated since February 28, 1913, have been distributed. Whenever one corporation receives from another corporation distributions out of earnings or profits accumulated by such other corporation prior to March 1, 1913, or out of increase in value of its property accrued prior to March 1, 1913, and the "receiving" corporation, after having first distributed all of its earnings and profits accumulated since February 28, 1913, distributes to its shareholders the amount so received by it from such other corporation, the distribution by the "receiving" corporation to its shareholders is not a dividend within the meaning of Title I and is exempt from tax.

In determining whether a dividend is out of earnings or profits accumulated since February 28, 1913, or prior to March 1, 1913, due consideration must be given to the facts, and mere bookkeeping entries increasing or decreasing surplus will not be conclusive.

* * * * *

U. S. GOVERNMENT PRINTING OFFICE: 1937

INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute and regulations involved	2
Statement	2
Summary of argument	5
Argument:	
The 1929 redemption was a capital transaction and the presumption in Section 115 (b) as to source of distribution is therefore not applicable	7
Conclusion	21
Appendix	22

CITATIONS

Cases:	
Baker v. *Commissioner*, 80 F. (2d) 813	10
Commissioner v. *Sansome*, 60 F. (2d) 931	10, 15
Craig v. *Commissioner*, decided March 15, 1937, C. C. A. 8th	4
Cullinan v. *Walker*, 262 U. S. 134	11
Edwards v. *Douglas*, 269 U. S. 204	9, 10
Eisner v. *Macomber*, 252 U. S. 189	11
Faris v. *Helvering*, 71 F. (2d) 619, certiorari denied, 293 U. S. 584	10
Gulf Oil Corp. v. *Lewellyn*, 248 U. S. 71	19
Hadley v. *Commissioner*, 36 F. (2d) 543	10
Harter v. *Helvering*, 79 F. (2d) 12	14, 15
Hedrick v. *Commissioner*, 24 B. T. A. 444	10
Helvering v. *Canfield*, 291 U. S. 163	20
Horrmann v. *Commissioner*, 34 B. T. A. 1178	10
Kennish v. *Commissioner*, 4 B. T. A. 303	11
Leland v. *Commissioner*, 50 F. (2d) 523, certiorari denied, 284 U. S. 656	10
Lucas v. *Alexander*, 279 U. S. 573	19
Lynch v. *Hornby*, 247 U. S. 339	14
Marr v. *United States*, 268 U. S. 536	11
McCord v. *Commissioner*, 31 B. T. A. 342	10
McCulloch v. *Commissioner*, 29 B. T. A. 67	10
Megeath v. *Commissioner*, 5 B. T. A. 1274	11
Murchison's Estate v. *Commissioner*, 76 F. (2d) 641	10
Old Colony R. Co. v. *Commissioner*, 284 U. S. 552	19
Rockefeller v. *United States*, 257 U. S. 176	11

Cases—Continued. Page

Southern Pacific Co. v. *Lowe*, 247 U. S. 330 19
Stewart v. *Commissioner*, 29 B. T. A. 809 15
United States v. *Kauffmann*, 62 F. (2d) 1045 10
United States v. *Phellis*, 257 U. S. 156 11
Untermyer v. *Commissioner*, 24 B. T. A. 906 10
Walker v. *Hopkins*, 12 F. (2d) 262, certiorari denied, 271 U. S. 687 10
Wilson v. *Commissioner*, 3 B. T. A. 957 11

Statutes:

Revenue Act of 1916, c. 463, 39 Stat. 756, Sec. 31 9
Revenue Act of 1917, c. 63, 40 Stat. 300, Sec. 1211 9
Revenue Act of 1918, c. 18, 40 Stat. 1057, Sec. 201 9
Revenue Act of 1921, c. 136, 42 Stat. 227, Sec. 201 9
Revenue Act of 1924, c. 234, 43 Stat. 253, Sec. 201 ..... 9, 12
Revenue Act of 1928, c. 852, 45 Stat. 791, Sec. 115 ..... 7 *et seq.*, 22
Revenue Act of 1936, c. 690, 49 Stat. 1648 20

Miscellaneous:

H. Rep. No. 179, 68th Cong., 1st Sess., pp. 11–12 13
I. T. 1802, II–2 Cumulative Bulletin 267 16
Regulations 74:
Art. 622 23
Art. 623 23
Regulations 94:
Art. 27 (f)–1 (b) 20
S. Rep. No. 398, 68th Cong., 1st Sess., pp. 11–12 12

In the Supreme Court of the United States

OCTOBER TERM, 1937

No. 189

BENJAMIN B. FOSTER AND ROBERT R. TODD, EXECUTORS OF THE ESTATE OF ANNA FOSTER FORD, DECEASED, PETITIONERS

v.

THE UNITED STATES

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The original opinion of the court below (R. 7–15) is reported in 17 F. Supp. 191. Its supplemental opinion on petitioners' motion for a new trial (R. 15–19) is reported in 18 F. Supp. 790.

JURISDICTION

The original judgment of the court below was entered December 7, 1936. (R. 15.) The order overruling petitioners' motion for a new trial was entered April 5, 1937. (R. 19.) The petition for a writ of certiorari was filed July 2, 1937 (R. 19), and granted on October 11, 1937 (R. 20). The

jurisdiction of this Court is invoked under Section 3 (b) of the Act of February 13, 1925.

QUESTION PRESENTED

Whether a dividend in 1930 was paid from earnings or profits accumulated after February 28, 1913. This depends upon whether the amount expended by the corporation in 1929 to redeem a portion of its stock is to be allocated against such earnings and thus exhaust them.

STATUTE AND REGULATIONS INVOLVED

The pertinent statutory provisions and Treasury Regulations are set forth in the Appendix, *infra*, pp. 22–24.

STATEMENT

This suit was brought to recover an alleged overpayment of income taxes for the year 1930. (R. 1–6.) The plaintiff died during this litigation and the executors of her estate, the petitioners herein, were substituted as parties. (R. 7.)

On February 11, 1930, decedent was the owner of 155 shares, par value $100 each, of the total of 1,500 shares of the capital stock of the Foster Lumber Company, a Missouri corporation. (R. 8.) On that day the corporation declared and paid a 150% cash dividend, namely, $225,000, on its capital stock, and decedent received as her share thereof the amount of $23,250, which she included in her income tax return for that year. (R. 8.)

Thereafter, decedent duly filed a claim for refund for the year 1930, contending that of the cash

dividend received by her only a portion thereof was paid from earnings or profits accumulated after February 28, 1913, and the dividend was therefore exempt to the extent of the remaining portion. The Commissioner of Internal Revenue rejected the claim upon the ground that there were ample earnings or profits (more than $225,000) accumulated since February 28, 1913, from which the dividend could have been paid. (R. 8.) The relevant facts in this regard are as follows:

On March 1, 1913, the corporation had outstanding 2,000 shares of its common stock having a par value of $100 each. Its accumulated earnings and increase in value of property at that date were in excess of $3,725,000.[1] (R. 8.) On October 10, 1929, in order to permit some of the stockholders to retire from ownership of and participation in the affairs of the corporation, it purchased and canceled 500 of the outstanding 2,000 shares of its cap-

[1] Between March 1, 1913, and October 10, 1929, the critical date herein, that amount had been only slightly reduced by dividends. In 1914, a dividend of $100,000 was paid, there being on hand at that time only $57,811.02 earnings accumulated *since* February 28, 1913; and in 1915 a similar dividend of $100,000 had only $48,798.73 recent earnings behind it. (R. 9–10.) All other dividends paid to 1929 were from earnings and profits accumulated subsequent to February 28, 1913. Accordingly, at the critical date, October 10, 1929, the only dividends which were paid from the March 1, 1913, surplus of over $3,725,000 were the 1914 dividend to the extent of $42,188.98 and the 1915 dividend to the extent of $51,201.27. Thus, on October 10, 1929, the March 1, 1913, surplus of over $3,725,000 had been reduced by total dividends of less than $100,000.

ital stock, expending therefor $1,025,000 cash. (R. 10.) This purchase of stock was on the basis of $2,050 per share, and it was subsequently agreed between the stockholders and the Government that the value of the stock on March 1, 1913, was also $2,050 per share. (R. 10–11.)

Immediately prior to the retirement of the 500 shares on October 10, 1929, the corporation had on hand earnings and profits in the amount of $330,578.98, accumulated since February 28, 1913. Additional earnings and profits in the amount of $82,758.17 were accumulated from October 10, 1929, to February 11, 1930, the date of the $225,000 dividend here involved. (R. 11.)

The taxpayer contended that the expenditure of $1,025,000 on October 10, 1929, exhausted all of the earnings and profits accumulated since February 28, 1913 ($330,578.98), and that therefore the $225,000 dividend paid on February 11, 1930, was taxable only to the extent that there were earnings or profits subsequent to October 10, 1929 (i. e., to the extent of $82,758.17). The Court of Claims, however, held that the October 10, 1929, expenditure was a capital transaction and was not to be charged against the earnings and profits accumulated since February 28, 1913.[2]

[2] The Board of Tax Appeals has held to the contrary in an unreported decision involving another stockholder in the same corporation. *Craig* v. *Commissioner*, decided March 15, 1937, now pending upon appeal to the Circuit Court of Appeals for the Eighth Circuit.

SUMMARY OF ARGUMENT

1. The redemption by the Foster Lumber Company of 25% of its stock in 1929 was a capital transaction. It was not the ordinary type of corporate distribution, and accordingly does not come within the purview of Section 115 (b).

2. Section 115 (b) creates an artificial presumption that corporate distributions are to be treated as having been made from earnings accumulated since February 28, 1913, to the extent thereof. This provision was intended to tax as dividends all corporate distributions to the extent that there were such earnings from which the distributions could have been made. It shows the general purpose of Congress to reach all such earnings, and to reach them in the hands of the stockholders as soon as possible. Accordingly, to apply Section 115 (b) to a non-taxable *capital* exchange would artifically deplete or wipe out the earnings account for future taxable distributions, and would thus frustrate the very object that Congress was trying to accomplish. Accordingly, we submit that Congress could not have intended Section 115 (b) to apply under such circumstances.

The lower courts have arrived at the same result in the analogous cases involving a consolidation of several corporations, each with a separate earnings account. Although in such cases those earnings accounts had been capitalized by the new corporation, and although stock of the new corporation had been *distributed* to the old stockholders so that

they might have been taxed upon such receipts in the absence of a specific statutory exemption, it has nevertheless been held that the old earnings accounts remain intact for the purpose of future taxable dividends. There is no more occasion for applying Section 115 (b) here than in those cases.

3. Assuming that Section 115 (b) does not apply, it then becomes pertinent to inquire how the $1,025,000 expended by the corporation in 1929 is to be allocated against the various corporate accounts. The Court of Claims held that since this taxpayer realized no taxable gain upon the redemption, and since the redemption was purely a capital transaction, none of it may be charged against the earnings accumulated after February 28, 1913. We think that result is sound. However, we suggest a second method which is perhaps an even more realistic approach to this question. This second method regards each share of stock as having behind it a proportionate share of each account. Accordingly, under this system, the payment of $1,025,000 in 1929 would be spread evenly over paid-in capital, earnings accumulated before March 1, 1913, and the more recent earnings. The result would be that there would be ample earnings left from which the corporation could have declared on February 11, 1930, its cash dividend of $225,000.

4. But even if Section 115 (b) is applicable, however, the 1929 redemption did not exhaust the recent earnings account. Section 115 (c) provides an exemption from the presumption established by

Section 115 (b) for the part "properly chargeable to capital account," and as there used "capital account" includes not only paid-in capital but also the March 1, 1913, surplus.

ARGUMENT

THE 1929 REDEMPTION WAS A CAPITAL TRANSACTION AND THE PRESUMPTION IN SECTION 115 (B) AS TO SOURCE OF DISTRIBUTION IS THEREFORE NOT APPLICABLE

1. *Preliminary.* The court below held that the redemption and retirement of the 500 shares on October 10, 1929, was a distribution in partial liquidation and capital transaction. This result seems plainly to follow from Section 115 (h) of the Revenue Act of 1928 (c. 852, 45 Stat. 791), which defines a "partial liquidation" as including "a distribution by a corporation in complete cancellation or redemption of a part of its stock," and from Section 115 (c), which provides as follows:

> *Distribution in liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. * * * In the case of amounts distributed in partial liquidation * * * the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the

> meaning of subsection (b) of this section for the purpose of determining the taxability of subsequent distributions by the corporation.

Petitioners contend, however, that of the $1,025,000 employed to redeem the 500 shares, $50,000 is chargeable to capital account, and that the remaining $975,000 must first be marshalled against the earnings or profits accumulated since February 28, 1913 (i. e., $330,578.98), before any of it can be applied against the earnings or profits on hand accumulated prior thereto. And to reach that result they must, of necessity, rely upon Section 115 (b), which provides:

> *Source of distributions.*—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the basis of the stock provided in section 113.

It is the Government's position that Section 115 (b) was enacted in order to tax as dividends any distributions made to stockholders to the extent there are earnings or profits accumulated after February 28, 1913, and that it was not intended

artificially to deplete such earnings account by a non-taxable capital exchange upon partial liquidation.

2. *The purpose of Section 115 (b) shows that it was not intended to apply to liquidations.*—In its present form Section 115 (b) of the Revenue Act of 1928 first appeared as Section 201 (b) of the Revenue Act of 1924 (c. 234, 43 Stat. 253). Those provisions and their precursors in earlier Revenue Acts[3] were intended by Congress to create an artificial presumption, so that corporate earnings could be taxed as soon as possible to the stockholders. No doubt, Congress had anticipated that in the absence of such provisions, various devices would be resorted to, such as purported distributions of capital, etc., in order to avoid the incidence of the tax upon the stockholders. To thwart such avoidance and to tax the stockholders at the earliest possible time with respect to the corporation's earnings, it was provided in substance by Section 115 (b) and its predecessors that any distribution which could be allocated against earnings from which taxable dividends could be declared would conclusively be presumed to have been made from such account.

[3] Somewhat similar provisions had appeared, as Section 201 (b) of the Revenue Act of 1921 (c. 136, 42 Stat. 227), and Section 201 (b) of the Revenue Act of 1918 (c. 18, 40 Stat. 1057). Section 1211 of the Revenue Act of 1917 (c. 63, 40 Stat. 300) added Section 31 (b) to the Revenue Act of 1916 (c. 463, 39 Stat. 756), providing not merely that distributions were to be charged against the most recent earnings but that the rate of tax was to depend upon the rate in effect at the time such earnings had been received by the corporation. See *Edwards* v. *Douglas*, 269 U. S. 204.

And in recognition of this purpose, the courts have generally applied those provisions to tax a stockholder-distributee whenever there were in fact any corporate earnings that could have supported the distribution. See *Baker* v. *Commissioner*, 80 F. (2d) 813, 815 (C. C. A. 2d); *Faris* v. *Helvering*, 71 F. (2d) 610 (C. C. A. 9th), certiorari denied, 293 U. S. 584; *Leland* v. *Commissioner*, 50 F. (2d) 523 (C. C. A. 1st), certiorari denied, 284 U. S. 656; *Hadley* v. *Commissioner*, 36 F. (2d) 543, 544 (App. D. C.). Cf. *Edwards* v. *Douglas*, 269 U. S. 204. Indeed, so zealous have the courts been in giving effect to the purpose of Congress to reach such earnings that where several corporations have combined under a new corporate structure capitalizing the accumulated earnings, it has been held, notwithstanding the absence of a specific statutory provision to that effect, that for tax purposes the earnings accounts remain intact. *Commissioner* v. *Sansome*, 60 F. (2d) 931 (C. C. A. 2d); *United States* v. *Kauffmann*, 62 F. (2d) 1045 (C. C. A. 9th); *Murchison's Estate* v. *Commissioner*, 76 F. (2d) 641 (C. C. A. 5th); *Baker* v. *Commissioner*, 80 F. (2d) 813 (C. C. A. 2d). Similarly, where a corporation capitalizes its earnings and distributes non-taxable stock dividends, it has been consistently held that the earnings account has not been impaired for dividend purposes.[4] And while the

[4] *Walker* v. *Hopkins*, 12 F. (2d) 262 (C. C. A. 5th), certiorari denied, 271 U. S. 687; *Horrmann* v. *Commissioner*, 34 B. T. A. 1178, 1182; *McCord* v. *Commissioner*, 31 B. T. A. 342; *McCulloch* v. *Commissioner*, 29 B. T. A. 67, 71–73; *Untermyer* v. *Commissioner*, 24 B. T. A. 906; *Hedrick* v.

stock dividend cases may possibly be explained away upon the ground that the issuance of a stock dividend is not a "distribution" (cf. *Eisner* v. *Macomber*, 252 U. S. 189), the reorganization cases remain as cogent authority here since exchanges in reorganization, like distributions in partial liquidation, are relieved of tax only by virtue of a specific statutory exemption. Cf. *United States* v. *Phellis*, 257 U. S. 156; *Rockefeller* v. *United States*, 257 U. S. 176; *Cullinan* v. *Walker*, 262 U. S. 134; *Marr* v. *United States*, 268 U. S. 536.

Accordingly, two things stand out clearly with respect to the general purpose of Congress. First, any distribution that can be taxed as a dividend by being charged against available corporate earnings is conclusively deemed to have been made from such earnings. And second, in furtherance of the first objective, if there is a non-taxable capital distribution, the earnings account is to remain intact for the purpose of future taxable distributions.

That Congress intended to treat partial liquidations distinct from ordinary corporate distributions plainly appears from Section 115 (c). There Congress provided that amounts so received by the stockholder, instead of being taxed as ordinary dividends, should "be treated as in part [5] or full

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Commissioner, 24 B. T. A. 444, 453–457; *Megeath* v. *Commissioner*, 5 B. T. A. 1274, 1285; *Kennish* v. *Commissioner*, 4 B. T. A. 303; *Wilson* v. *Commissioner*, 3 B. T. A. 957.

[5] There are two kinds of partial liquidation as defined in Section 115 (h). The first type is the "complete cancellation or redemption of a part" of the stock, as was the case here. The second type is "one of a *series* of distributions in

payment in exchange for the stock." And it is further provided that "the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of subsection (b) of this section for the purpose of determining the taxability of subsequent distributions by the corporation."

Section 115 (c) of the 1928 Act first appeared in the law as Section 201 (c) of the Revenue Act of 1924, and the reports of both the Senate and House Committees with respect to the bill which became the 1924 Act, plainly indicated that Congress understood these provisions as dealing with capital transactions as distinguished from ordinary distributions. The Senate Finance Committee stated (S. Rep. No. 398, 68th Cong., 1st Sess., pp. 11–12):

> * * * A liquidating dividend is, in effect, a sale by the stockholder of his stock to the corporation; he surrenders his interest in the corporation and receives money in place thereof. * * *
>
> The theory of liquidating dividends is extended to distributions in partial liquidation. If a corporation retires a portion of

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complete cancellation or redemption of all or a portion" of the stock. [Italics supplied.] Accordingly, the part payment referred to in Section 115 (c) presumably refers to this second type of distribution in partial liquidation. The type of partial liquidation involved herein, however, should therefore be treated as in "*full* payment in exchange for the stock" within the meaning of Section 115 (c). [Italics supplied.]

> its capital stock, the transaction is treated, from the point of view of the stockholder, as a sale of his stock. If the corporation distributes an amount in partial retirement of its capital stock, the amount thereof is to be considered as a return of capital, and taxable only if, as, and to the extent that it exceeds the basis of the stock.

Similar comments appear in the report of the House Ways and Means Committee report. See H. Rep. No. 179, 68th Cong., 1st Sess., pp. 11–12.

The purchase by the Foster Lumber Company of 25% of its own stock for redemption was therefore not a "distribution" in the dividend sense. It was a capital transaction, and the stockholder might either realize gain or suffer loss depending upon whether the amount received exceeded or was less than the basis for such stock. And as to the stockholder in this very case no taxable gain was realized, since the stock which was redeemed at the rate of $2,050 a share had the same value on March 1, 1913, the critical date for determining the basis of this stock. (R. 10–11.)

Thus, to apply Section 115 (b) here would frustrate the very end that Congress was attempting to achieve by those provisions. The artificiality of the presumption, together with the cases applying it, plainly show that Congress was deeply concerned not only with taxing corporate earnings to the stockholder but with imposing the tax as soon as possible. If the Section 115 (b) formula were

employed here, the earnings account would be exhausted in a nontaxable exchange, and the corporation would be free to distribute the earnings actually remaining, exempt from tax to the stockholder. That Congress could have intended so perverse a result to follow from the very language that it had carefully employed to subject the stockholder to tax seems difficult if not impossible to believe.

We respectfully submit that Section 115 (b) is applicable to distributions as that term is commonly understood where the distribution might be treated as a dividend, and that it is not to be applied where there are capital transactions in the nature of stock redemptions. Cf. *Lynch* v. *Hornby*, 247 U. S. 339, 341. That capital transactions are to be treated differently from ordinary distributions, has already been recognized by the lower courts in holding that upon consolidation or merger of two or more corporations, the earnings accounts of the combining corporations remain intact in spite of the technical distribution to the stockholders that generally occurs under such circumstances. There is no more occasion for applying Section 115 (b) here than in those cases.*

* The petition for certiorari herein suggests that the presumption was applied in *Harter* v. *Helvering*, 79 F. (2d) 12 (C. C. A. 2d), and that since that case involved a distribution in partial liquidation, the decision is contrary to that of the Court of Claims here. The two cases, however, are consistent. First, while there was a distribution in redemption of stock by the Boxboard Products Company in that case,

3. *The proper allocation of the redemption in partial liquidation.*—Thus far, we have shown that the artificial presumption created by Section 115 (b) is inapplicable here, and that the purchase of its own stock by the Foster Lumber Company is not to be allocated first against its most recent earnings account before it can be charged against the pre-March 1, 1913, earnings. There remains, however, the further question as to how that amount should be allocated, whether any *portion* of the recent earnings may be considered as having contributed toward the partial liquidation.

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the distribution to which the presumption was applied was an earlier non-capital distribution by the so-called New Company to Boxboard Products Company. Of course, the presumption was applicable there. And second, even if the presumption were applied to the partial liquidation, it would have been proper under the law then in force. The key transactions took place in 1923 while the Revenue Act of 1921 (c. 136, 42 Stat. 227) was in effect. Under that Act there was no provision comparable to Section 115 (c) of the 1928 Act, and distributions in liquidation were treated under that statute, not as capital transactions, but as dividends to the extent of available earnings accumulated since February 28, 1913. The Circuit Court of Appeals for the Second Circuit has specifically recognized this in *Commissioner* v. *Sansome*, 60 F. (2d) 931, 932.

The case of *Stewart* v. *Commissioner*, 29 B. T. A. 809, relied upon by petitioner, similarly has no relevance here. The Board plainly stated (p. 813) that a partial liquidation was not there involved.

Accordingly, we submit that neither the *Harter* nor *Stewart* case touches the question whether the presumption in Section 115 (b) should be applied to a capital transaction such as is involved herein.

We will discuss two possible methods of allocating the $1,025,000 expenditure against the various accounts of the corporation: first, the method used by the Court of Claims of not charging any portion against recent earnings; and second, the method of pro-rating the distribution evenly over all the accounts of the corporation, including the recent earnings. Both methods are sound and either of them would defeat petitioners' claim.

First. Since petitioners' decedent had no taxable gain upon the redemption in 1929, and since the redemption was purely a capital transaction, there is much cogency to the holding of the Court of Claims that the recent earnings were not invaded at all. That conclusion is reinforced by the general and dominant purpose of Congress to tax recent corporate earnings as far as possible to the stockholders. Accordingly, that purpose is given effect by keeping intact the reservoir of earnings from which taxable dividends could be declared whenever there is a non-taxable distribution.

That method is in accord with administrative practice of long standing. As early as I. T. 1802, II–2 Cumulative Bulletin 267, with respect to prior Revenue Acts, the Treasury had ruled that premiums paid in retiring capital stock should be charged first against the March 1, 1913, surplus. And the Treasury has consistently since then continued that practice.

Second. The second method, which we suggest is perhaps a more realistic approach to this problem.

It regards each share of stock as having behind it a proportional part of the various accounts of the corporation. Thus, each of the 2,000 outstanding shares on October 10, 1929, can be regarded as comprehending a proportionate share of the $200,000 paid-in capital, of the $330,578.98 earnings and profits accumulated since February 28, 1913, and of the undistributed earnings and profits accumulated prior to March 1, 1913.[7]

Accordingly, under this method, if the total net assets of the corporation be treated as $4,100,000,[8] the distribution of $1,025,000 would be charged against the earnings account of $330,578.98 to the extent of $\frac{1,025,000}{4,100,000}$, or in the amount of $82,664.75. Thus, the October, 1929, redemption would reduce the recent earnings account only to $247,934.25, which, even without the later earnings from October 10, 1929, to February 11, 1930, would be more than ample to pay the February 11, 1930, dividend of $225,000 here involved.

It will be noted that we have not discussed what part of the $1,025,000 "is properly chargeable to

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[7] On March 1, 1913, the surplus was $3,725,000. (R. 8.) And as shown in footnote 1, *supra*, that amount had been reduced by dividends thereafter in the aggregate amount of less than $100,000.

[8] This figure is arrived at by multiplying the 2,000 shares by $2,050, the amount which was treated as the value of each share. A somewhat greater figure would be reached by adding (1) $200,000 capital, (2) $330,578.98 recent earnings, and (3) the undistributed pre-March 1, 1913, earnings, which would be in excess of $3,625,000 if the 1913 amount is diminished by the 1914 and 1915 dividends to the extent that they invaded it.

capital account" within the meaning of Section 115 (c). For, if our contention that Section 115 (b) is inapplicable be accepted, then it is not material here how much should be charged to capital or whether "capital account" means merely paid-in capital, or March 1, 1913, surplus in addition to paid-in capital. The real issue is whether, even if the narrowest definition of "capital account" be adopted, the amount of the distribution in excess of that portion allocable to such capital account, should be attributed, first, to the recent earnings, and our position is that it should not. Accordingly, under our view that the excess is to be spread evenly over the various accounts of the corporation, the crucial question is how much, if any, must be allocated to the post-February 28, 1913, earnings. And we have shown (p. 17, *supra*) that such earnings account of $330,578.98 would be depleted at most in the amount of $82,664.75.

4. *But even if Section 115 (b) is applicable, then the 1929 redemption did not exhaust the recent earnings account, since the "capital account" of the corporation includes not only its paid-in capital but also the March 1, 1913, surplus.*—Assuming that we are incorrect as to the inapplicability of Section 115 (b), then the Government is still entitled to prevail. Under Section 115 (c) it is specifically provided that "the part of such distribution which is properly chargeable to capital account shall not be

considered a distribution of earnings or profits within the meaning of subsection (b) of this section * * *." And as we shall show, Congress employed the term "capital account" loosely to mean paid-in capital plus March 1, 1913, surplus.

Under this interpretation, the amount properly chargeable to capital would be $\frac{4,100,000 \text{ minus } 330,578.98}{4,100,000} \times$ $1,025,000, or $942,335.25. In short, there would remain only $82,664.75 to be taken out of post-February 28, 1913, earnings.

We submit that the clause "properly chargeable to capital account" refers broadly not merely to the technical paid-in capital, but also to the March 1, 1913, surplus. While Congress undoubtedly could tax dividends paid from pre-March 1, 1913, earnings (*Lynch* v. *Hornby,* 247 U. S. 339), it has elected not to do so, and has treated such earnings just as though they were capital for the purpose of determining taxability upon distribution. See *Southern Pacific Co.* v. *Lowe,* 247 U. S. 330, 335:

> * * * we are bound to consider accumulations that accrued to a corporation prior to January 1, 1913, *as being capital,* not income, for the purposes of the act. [Italics supplied.]

See also *Gulf Oil Corp.* v. *Lewellyn,* 248 U. S. 71, 72; *Lucas* v. *Alexander,* 279 U. S. 573, 577; *Old Colony R. Co.* v. *Commissioner,* 284 U. S. 552, 556, Note 3. The question here is the intention to be

ascribed to Congress in using the term "capital," and we submit that it was used in the sense in which this Court has repeatedly used the same term.[9]

True, in *Helvering* v. *Canfield,* 291 U. S. 163, the Court said that the March 1, 1913, surplus was not "capital" in the sense that where it had been reduced by deficits, later earnings had to be applied to restore that fund before such later earnings could be distributed as taxable dividends. That decision, however, dealt not with the meaning of

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[9] A recent instance of the broad use of the term capital account to include March 1, 1913 surplus, is found in Treasury Regulations 94, dealing with the undistributed profits tax under the Revenue Act of 1936 (c. 690, 49 Stat. 1648). Article 27 (f)–1 (b) of those regulations states:

(*b*) *Amount properly chargeable to earnings or profits.*— In the case of a distribution in liquidation with respect to which a dividends paid credit is allowable (see paragraph (a) of this article) the amount of the credit is equal to the part of such distribution which is properly chargeable to the earnings or profits accumulated after February 28, 1913. To determine the amount properly chargeable to the earnings or profits accumulated since February 28, 1913, there must be deducted from the amount of the distribution that part allocable to capital account. *The capital account, for purposes of these regulations, includes* not only amounts representing the par or stated value of the stock with respect to which the liquidating distribution is being made but also that stock's proper share of the paid-in surplus, and *such other corporate items, if any, which, for purposes of income taxation, are treated like capital in that they are not taxable dividends when distributed but are applied against and reduce the basis of the stock.* The remainder of the distribution in liquidation is, ordinarily, properly chargeable to the earnings or profits accumulated since February 28, 1913. [Italics in body supplied.]

the term "capital" as used in this or any other provision of the Revenue Acts, but with the concept of capital as a matter of corporate law. Furthermore, the very basis of that decision fortifies the result here. That decision proceeded in full recognition of the dominant purpose of Congress to tax as dividends corporate distributions to the extent that there were earnings after February 28, 1913, available, and that taxability was not to be defeated by any such artificial concept. We are confronted here by the same dominant purpose of Congress, and respectfully submit that the term "capital account" as loosely employed by it in Section 115 (c) should be construed to give effect to that purpose.

CONCLUSION

The judgment below should be affirmed.

Respectfully submitted,

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DECEMBER, 1937.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

(a) *Definition of dividend.*—The term "dividend" when used in this title (except in section 203 (a) (4) and section 208 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.

(b) *Source of distributions.*—For the purposes of this Act every distribution is made out of earnings or profits to the extent thereof, and from the most recently accumulated earnings or profits. Any earnings or profits accumulated, or increase in value of property accrued, before March 1, 1913, may be distributed exempt from tax, after the earnings and profits accumulated after February 28, 1913, have been distributed, but any such tax-free distribution shall be applied against and reduce the basis of the stock provided in section 113.

(c) *Distributions in liquidation.*—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock, and amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock. The gain or loss to the distributee resulting from such exchange shall be determined under section 111, but shall be recognized only to the extent provided in section 112. In the

case of amounts distributed in partial liquidation (other than a distribution within the provisions of section 112 (h) of stock or securities in connection with a reorganization) the part of such distribution which is properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of subsection (b) of this section for the purpose of determining the taxability of subsequent distributions by the corporation.

* * * * *

(h) *Definition of partial liquidation.*—As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

Treasury Regulations 74:

ART. 622. *Source of distribution.*—For the purpose of income taxation every distribution made by a corporation is made out of earnings or profits to the extent thereof and from the most recently accumulated earnings or profits.

ART. 623. *Distributions out of earnings or profits accumulated, or increase in value of property accrued, prior to March 1, 1913.*—Any distribution by a corporation out of earnings or profits accumulated prior to March 1, 1913, or out of increase in value of property accrued prior to March 1, 1913 (whether or not realized by sale or other disposition, and, if realized, whether prior to or on or after March 1, 1913), is not a dividend within the meaning of Title I. A corporation can not distribute earnings or

profits accumulated or increase in value of property accrued prior to March 1, 1913, exempt from tax, unless and until all earnings or profits accumulated since February 28, 1913, have been distributed. Whenever one corporation receives from another corporation distributions out of earnings or profits accumulated by such other corporation prior to March 1, 1913, or out of increase in value of its property accrued prior to March 1, 1913, and the "receiving" corporation, after having first distributed all of its earnings and profits accumulated since February 28, 1913, distributes to its shareholders the amount so received by it from such other corporation, the distribution by the "receiving" corporation to its shareholders is not a dividend within the meaning of Title I and is exempt from tax.

In determining whether a dividend is out of earnings or profits accumulated since February 28, 1913, or prior to March 1, 1913, due consideration must be given to the facts, and mere bookkeeping entries increasing or decreasing surplus will not be conclusive.

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U. S. GOVERNMENT PRINTING OFFICE: 1937

SUPREME COURT OF THE UNITED STATES.

No. 189.—October Term, 1937.

Benjamin B. Foster and Robert R. Todd, Executors of the Estate of Anna Foster Ford, Deceased, Petitioners,
vs.
The United States.

On Petition for Writ of Certiorari to the Court of Claims.

[January 31, 1938.]

Mr. Justice Black delivered the opinion of the Court.

Petitioners' right (as executors) to an income tax refund depends upon whether a dividend paid by the Foster Lumber Company in 1930 is tax exempt as representing corporate earnings accumulated before March 1, 1913. This dividend is taxable under the Revenue Act of 1928[1] if paid from earnings accumulated after 1913. The Court of Claims found the dividend taxable.[2]

Petitioners contend that the 1930 dividend was traceable to the Company's pre-1913 accumulations because its post-1913 earnings had been exhausted by a distribution in 1929. The circumstances of the 1929 distribution and the 1930 dividend were:

The Foster Lumber Company was a family corporation, organized in 1896 with a capital stock of $200,000. March 1, 1913, when the federal income tax became effective, the increased value of the company's property and its undistributed profits were more than $3,725,000. Petitioners insist that a distribution of $1,025,000 on October 10, 1929, completely exhausted the $330,578.98 total undistributed profits which had accumulated since March 1, 1913. This 1929 distribution, however, was not a dividend. It was paid by the company to cancel and liquidate five hundred shares of its own $100 par value stock and represented payment of $2,050 per share, the agreed value as of March, 1913. February 11, 1930, the company declared a $225,000 dividend and this refund is sought for the tax paid upon a shareholder's part of this dividend. Be-

[1] c. 852, 45 Stat. 791.

[2] 17 Fed. Supp. 191; (supplemental opinion) 18 Fed. Supp. 790. Certiorari granted, 302 U. S. —.

tween October 10, 1929 (the date of the $1,025,000 stock purchase) and February 11, 1930 (the date of the $225,000 dividend) the company's earnings amounted to only $82,758.17. Petitioners take the position that only $82,758.17 of this $225,000 dividend of 1930 can be taxed, urging that the balance is tax exempt because it must be treated as representing pre-1913 accumulations.

Subsection (a) of Section 115 of the Revenue Act of 1928[3] defines "dividend", for income tax purposes, as "any distribution made by a corporation to its shareholders, . . . out of its earnings or profits *accumulated after February 28, 1913.*"

Subsection (b) of this income tax law exempts corporate earnings and profits accumulated before March 1, 1913. This subsection also provides that for income tax purposes all distributions are paid from "the most recently accumulated earnings or profits." The obvious purpose of the provision was to prevent corporations from attributing dividend payments to pre-1913 accumulations to avoid taxes imposed upon profits earned after March, 1913. Petitioners' contention is that the $330,578.98 earned after 1913, as "the most recently accumulated earnings or profits" was automatically exhausted in part payment of the $1,025,000 stock purchase and thus escaped taxation. In this manner, pre-1913 corporate non-taxable earnings could be used to avoid taxes on corporate profits earned after 1913.

We have previously said that Subsections (a) and (b), *supra*, construed together, disclose legislative purpose that pre-1913 accumulations shall not be distributed "in such a fashion as to permit profits accumulated after that date to escape taxation."[4] Petitioners ask that we now construe these provisions in a way which would facilitate the escape of such profits from taxation and thereby defeat the undoubted purpose of Congress. We are urged so to expand and broaden an exemption granted by Congress as a "concession to the equity of stockholders"[5] that such concession would in reality serve to nullify and defeat the tax on corporate profits earned after 1913. Courts should construe laws in harmony with the legislative intent and seek to carry out legislative purpose. With respect to the tax provisions under consideration, there is no uncertainty as to the legislative purpose to tax post-1913 corporate

[3] Revenue Act of 1928, c. 852, 45 Stat. 791, 822.
[4] Helvering *v.* Canfield, 291 U. S. 163, 168.
[5] Lynch *v.* Hornby, 247 U. S. 339, 346.

earnings. We must not give effect to any contrivance which would defeat a tax Congress plainly intended to impose. The use of bookkeeping terms and accounting forms and devices cannot be permitted to devitalize valid tax laws.

The transaction under which this Company paid $1,025,000 cash for its own stock of $50,000 par value does not fall within Subsections (a) and (b) of Section 115. Its character and effect are determined by Subsections (c) and (h) which relate to distributions in complete or partial corporate liquidation.[6]

Subsection (c), governing this stock purchase transaction, directs that "... In the case of amounts distributed in partial liquidation ... the part of such distribution which is *properly chargeable to capital account shall not be considered a distribution of earnings or profits within the meaning of subsection* (b) ... *for the purpose of determining the taxability of subsequent distributions* ..."[7]

This provision of the Revenue Act of 1928 also substantially obtained in the Revenue Act of 1924.[8] Prior even to the 1924 Act, this Court had determined that, for income tax purposes, earnings of a corporation accumulated prior to 1913 are to be considered capital.[9] In the light of these decisions, Congress obviously intended that corporate funds distributed under the circumstances here shown should be "chargeable to capital account" and that stock purchases of the type here involved should not be considered "for the purpose of determining the taxability of subsequent distributions by the corporation."

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[6] Cf. Hellmich v. Hellman, 276 U. S. 233, 237.

[7] Subsection (h) (Revenue Act of 1928, *supra*, at 823): "Definition of partial liquidation.—As used in this section the term 'amounts distributed in partial liquidation' means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock."

[8] Sec. 201 (c), c. 234, 43 Stat. 253, 255.

[9] "... we are bound to consider accumulations that accrued to a corporation prior to January 1, 1913, as ... capital, ..." So. Pac. Co. v. Lowe, 247 U. S. 335 (1917). Also, see Lynch v. Turrish, 247 U. S. 221; Doyle v. Mitchell Bros. Co., 247 U. S. 179 (1917); "... what is called the stockholder's share in the accumulated profit of the company is capital, ..." Eisner v. Macomber, 252 U. S. 189, 219 (1919). Cf.: "... income ... (received) ... prior to the adoption of the Sixteenth Amendment ... had become capital prior to the adoption of the Amendment ..." Old Colony R. Co. v. Comm., 284 U. S. 557; and "... the accumulated profits, as they stood on March 1, 1913, constituted capital of the company ..." Helvering v. Canfield, 291 U. S. 167.

Acceptance of petitioners' contention would permit corporate profits accumulated since March, 1913 to escape taxation, contrary to the provisions and purpose of the 1928 Revenue Act. The bookkeeping mingling of corporate earnings and profits made before and after March 1, 1913, does not alter the Act nor can such action render taxable profits non-taxable. In this case, the distribution of $1,025,000 was "properly chargeable to capital account" and was not paid out of profits earned since March 1, 1913.

The $1,025,000, paid for the Company's stock, cannot, therefore, be considered "for the purpose of determining the taxability of subsequent distributions by the corporation" and this purchase of stock did not exhaust any part of the $330,578.98 profits accumulated since 1913. It follows that the total dividend of 1930 received by petitioners' decedent is taxable and the judgment of the Court of Claims is

Affirmed.

Mr. Justice CARDOZO took no part in the consideration or decision of this case.

A true copy.

Test:

Clerk, Supreme Court, U. S.